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ACCELERATING THE DEVELOPMENT PROCESS

Challenges for national and international policies in the 1990s

REPORT BY THE SECRETARY-GENERAL OF UNCTAD TO UNCTAD VIII

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EXPLANATORY NOTE

(i) The scope, structure and subject coverage of the present report has been determined by the contents of the agenda for UNCTAD VIII as agreed by member Governments. This agenda seeks to build on the platform provided by the Final Act of UNCTAD VII and is inspired by the Declarations adopted by the United Nations General Assembly on the occasion of the Twenty-fifth Anniversary of UNCTAD in 1989 and at its special session held in 1990 on international economic co-operation, in particular the revitalizing of economic growth and development of the developing countries.

(ii) The unifying theme of the agenda - namely, strengthening national and international action and multilateral co-operation for a healthy, secure and equitable world economy - reflects the interests of all groups of countries. It provides the broad framework for the consideration of policy issues by the Conference. An important feature in this regard is that for the first time within the institution the agenda expressly requires the Conference to address the national as well as the international dimensions of the development problématique.The report accordingly gives attention to both of these dimensions.

(iii) The agenda envisages as the starting point for the work of the Conference an evaluation of the challenges and potentials which long-term structural changes imply for sustainable development and the expansion of international trade in an interdependent world economy. Part One of the report seeks to provide the elements for such an evaluation, including the implications for the current manifestations of long-standing problems and for relatively recent concerns.

(iv) One such concern in sustainable development. This theme permeates the report as a whole and its ramifications in particular policy areas are examined in the relevant chapters of Parts Two and Three.

(v) At the level of action, the agenda is aimed at the promotion of economic growth, technological capabilities and accelerated development in the developing countries. With this aim in view, the Conference is expected to evolve guidelines for national and international policies and measures, good management and structural reforms in both developed and developing countries. The objective of such guidelines would be to achieve the effective and efficient allocation, use and mobilization of human and economic resources and a more favourable international economic environment.

(vi) Guided by these considerations, Part Two of the report deals with broad policy responses which could accelerate the tempo of development. In this context, the report addresses the concept - new and so far controversial in UNCTAD - of "good management", including the role of market forces and public policy, in the promotion of development.

(vii) Finally, the agenda identifies, for consideration by the Conference, specific policy issues in the following five interrelated areas: resources for development; international trade; technology; services; commodities. These are addressed in Part Three of the report with particular reference to desirable national as well as international policies and taking full account of the objectives of sustainable development and good management.

Part One

WORLD ECONOMIC TRENDS AT THE BEGINNING OF THE 1990s: CHANGE AND STAGNATION

Chapter I

THE CHALLENGE AND POTENTIALS OF CHANGE

1. The eighth session of the United Nations Conference on Trade and Development will take place at a singularly complex and challenging time. Long-term changes in economic structures and international economic relations, whose origins in some cases date back decades, are now unfolding at an accelerated pace. To these has been added a host of realignments in national economic systems, social perceptions and approaches to national and international development policy, as well as in international political relations.

2. The result is a fluid, often contradictory and largely unpredictable global context, that is fraught with serious potential dangers and pitfalls, but which also offers considerable opportunities for promoting international development.

3. Several positive conditions have come into being for strengthening international economic cooperation for development. Over the past several years steady, though recently decelerating, growth in global output and trade has strengthened the possibilities for revitalizing the development process. Some parts of the developing world have indeed registered rapid economic growth. Yet, long-standing problems of stagnation, poverty and marginalization, compounded by inequitable international economic relations - notably in trade, commodities, resource flows and technology - persist in most developing countries, and in many of them, including the least developed, they have reached crisis proportions.

4. The problems with which developing countries continue to grapple are present in varying combinations. They include acute difficulties in expanding and diversifying the production base, in reducing commodity dependence, in building financial, technological and transport capacities, in coping with the debt burden and its consequences as well as with adverse trends in resource flows, and pursuing adjustment programmes oriented to growth and development. Structural changes and other trends in the world economy, whose potential impact is amplified by the growing interdependence of economies and of policy areas, have brought the means of overcoming many of these difficulties within reach, or at least into the realm of possibility. In the absence of adequate national and international responses, however, these factors have served to deepen the disarray in the development process. They have also heightened the vulnerability of developing countries to adverse changes in the international economic environment.

5. Furthermore, new areas of concern have attained greater prominence in the dialogue on international economic cooperation. Significant shifts are taking place in perceptions regarding national and international development policy.

Major efforts are being made to promote approaches to growth which, responding to the needs of present and future generations, would at once eradicate poverty and promote ecologically sound and sustainable development. The use of market signals and competitiveness, and promoting entrepreneurial initiative, to optimize the contributions of the public and private sectors are becoming common features of the pursuit of economic efficiency.

6. The debate continues on how best to integrate considerations of economic efficiency and sound management at the domestic level with broader national and international development objectives. The increasingly dense interplay between trade, foreign direct investment, the globalization of economic activity as well as of corporate operations, technology transfer and services has added a further dimension to the development problematique. The policy implications of the integration processes currently under way in the world economy are commanding greater attention, as are those of the diversity of growth and development experiences of different countries. The question has also been raised of a possible shortage of global savings in relation to capital requirements, which may lead to upward pressure on international interest rates, aggravate the debt problems of developing countries and weaken the international financial system.

7. The formidable task thus facing the Conference, as a forum with a central development mission and a perspective encompassing the interrelationships of a wide range of issues, is to address the long-standing problems of growth and development just mentioned in the context of these emerging concerns. 1/ The objective is to work out innovative policy approaches and concrete measures which would strengthen national and international action towards a more healthy, secure and equitable world economy. In so doing the Conference would breathe new life into the development dialogue, give much needed impetus to multilateral economic cooperation and also impart fresh vigour to UNCTAD itself.

A. The evolving international political context

8. The past few years have been a period of often unforeseen developments in the global political environment, unusually rapid shifts in political alignments, and far-reaching changes in international relations. The most important of these changes was, of course, the marked easing of military and political tension between the major Powers which has transformed East-West relations. Efforts to reduce nuclear and other armaments gained momentum; a comprehensive conventional forces treaty in Europe was concluded and a strategic arms reduction treaty came within reach. These developments raised expectations that some of the resources currently devoted to military purposes could be diverted to socially productive ends, including development cooperation. There was growing confidence that the spectre of world war had receded, lending substance to the age-old vision of beating swords into ploughshares. The prospects also improved for curbing the incidence and scale of threats to regional security and, in the event, some progress has already been registered in the resolution of local conflicts in parts of Africa, Asia and Central America. This evolution fuelled hopes that many developing countries would be able to boost domestic resources committed to development efforts by redeploying an increasing proportion of their military expenditures.

9. The broad tide of political reform in many parts of the world gathered pace. International consensus confirmed the view that economic growth must be broadly based, offering equal opportunities to all people, both women and men, to participate fully in political as well as economic and social activities. Governments increasingly accepted that respect for human rights stimulates creativity, innovation and initiative in their societies. Vigorous efforts were pursued in the developing world to adapt and improve the flexibility of economies, as well as to enhance the efficient use of resources. They were accompanied in many countries by a new movement towards the democratization of political structures, encompassing greater accountability, transparency in decision-making and the rule of law.

10. Dramatic and unforeseen developments occurred in most Central and Eastern European countries leading to the introduction of democratic forms of government in place of existing regimes, and encompassing the unification of Germany. The democratization process was accompanied by far-reaching institutional changes, rapid moves to market-based economic systems and further integration into the world economy. On the basis of a sober assessment of the tasks ahead, all countries in the region are addressing the challenges of complex economic and institutional reforms in an external environment more difficult than originally envisaged and, in some cases, in the midst of significant social and political tensions.

11. Other developments, however, infringed on these positive trends. The recent war in the Middle East cast a pall on perceptions that the world had moved into a new era of solidarity and dialogue for political accommodation. It has left in its wake enormous human suffering, material damage and political instability within the region and generated strongly negative consequences for many developing and other countries. It has also contributed to the recessionary outlook in developed countries and imposed significant deadweight costs on future world economic growth. In addition, the turn of events also gave rise to some scepticism about the chances of reducing current levels of military expenditures, mainly in the developed but also in the developing world, and of turning the immense resources they represent to peaceful uses. More recently, there has been open discussion of the emerging tension between long-standing principles of national sovereignty and external initiatives to defend internationally recognized norms of respect for human rights and humanitarian solidarity. Resolving this tension requires further international consensus-building, involving the participation of all countries and taking into consideration the implications for international peace and security.

12. The abrupt changes in Central and Eastern Europe and in East-West relations have also prompted a fundamental examination in many developing countries of their place, individually and collectively, in the emerging configuration of political and economic power. Indeed, there are fears that, except where the strategic concerns of major countries are directly involved, the vital interests of developing countries are losing their salience on the international agenda. The reduction of traditional geo-political rivalries could blunt the impetus to multilateral action on poverty and underdevelopment in some regions of the developing world. Moreover, if in the new circumstances developed countries were to feel free to pursue their particular economic interests in a less inhibited fashion, a dangerous intensification of

conflicts could follow, for example over trade, exchange rates and macroeconomic policies. Although the changes in Central and Eastern Europe have served to accelerate the processes of integration in Europe, the strategic political and economic implications of these processes for the developing world remain uncertain.

13. Another source of disquiet is that the costs of the transition in countries in Central and Eastern Europe are now likely to be considerably higher than expected in terms of political and economic stability as well as resources and welfare. The reforms will, in any event, take time to bear fruit. The OECD countries have placed on record assurances regarding the high priority they would continue to attach to development cooperation with the third world. However, the strong support that they have undertaken to give to the processes of reform in the Central and Eastern European countries raises legitimate concerns. The most pervasive of these concerns is the possibility that, far from being augmented, trade, aid, investment, loans and technology flows may be diverted away from developing countries.

14. Any such tendencies must be firmly resisted, not least because they would breed political and economic insecurity and nourish divisive forces among and within nations. In general, the fading of the cold war, together with the emergence of multi-polarity in the world economy, presents an opportunity to revive multilateral approaches to the solution of pervasive economic problems. It thus offers greater scope for evolving and pursuing effective policies for growth and development. The deepening of current worldwide trends towards democratization may induce stronger recognition that a more democratic international governance is essential for the collective welfare of the world community. It may also promote a wider appreciation that balanced development in the world economy is a major factor for world peace and stability. Moreover, these trends could foster greater international tolerance of differing choices by countries of specific ways of orienting the pursuit of economic efficiency towards broader development goals.

15. The relaxation of global tensions could, by lessening concerns over military security in major industrial countries, promote reductions in defence expenditures and facilitate a better budget balance in their economies. It may also help to release resources, depending on their capacities and on adjustment and transitional costs, for easing global economic strains and for supporting the development process. Likewise, if it enables legitimate security concerns in troubled regions to be effectively addressed, developing countries should be able to redeploy an increasing proportion of resources currently devoted to military expenditures for the purpose of raising domestic living standards. Arms exporting countries could greatly contribute to this process by exercising stronger restraints on arms transfers and sales, as well as their promotion.

16. Furthermore, political pluralism in national contexts can contribute to accountability and consequently to a more efficient use of resources as well as transparency in domestic decision-making. More fully representative political systems may also be expected to stimulate wider popular participation in the development process and the full observance of human rights, economic as well as political and civil. These prospects, however, could come under threat from, and be reversed by, social upheavals stemming from the persistence of disarray and stagnation in the development process.

B. Technological advance and international competitiveness

17. At the root of many of the structural changes that are taking place in the world economy is technological progress. The technological revolution, characterized in the main by advances in micro-electronics but also encompassing new materials, biotechnology and, prospectively, renewable energy, is having a profound effect on the nature of world economic activity and international economic relations. It has given fresh impulse to economic integration, both global and regional, and to changes in patterns of production and exchange in many fields, including information and communications and, in varying degrees, transportation, manufacturing and agriculture. Knowledge-intensive and information-based processes have become increasingly important in determining the product composition of output and the material composition of products.

18. One significant result of these changes is the growing importance of the service sector in the advanced economies. In particular, producer services - those used by enterprises as inputs in their own production of goods and services - have emerged as a highly dynamic sector, and as a major determinant of productivity and competitiveness. International trade in services has grown rapidly, and the linkages between trade, technology, investment and services have grown more intense. These linkages have brought about a wider appreciation of the strategic importance of services for the development process and enhanced its salience in multilateral negotiations.

19. These factors constitute a formidable addition to the array of problems already facing most developing countries in the pursuit of their development goals. But they also offer seeds of opportunity which, if adequately nurtured and brought to fruition through appropriate domestic and international policy, would contribute to the development effort. For example, all countries stand to benefit from less costly data generation processing and transmission and from more efficient access to telecommunications. Information technologies have sharply improved efficiency in the conduct of trade transactions in some advanced countries and have thus enhanced their competitiveness. With appropriate international impetus, these technologies should benefit all trading partners. Combined with the relatively low cost of skilled labour, many of the technological advances already mentioned could open up new areas of economic activity for developing countries, particularly in the services sector, and enable them to take advantage of new trading opportunities.

20. Generally, micro-electronic technologies could accelerate industrial development in the developing world but much depends on the potential for synergy between skills, enterprise capabilities, incentives and institutions. These technologies offer possibilities for transforming and improving the performance of products and processes, for the rapid handling of information, and for strengthening the effectiveness of other technologies. Biotechnology has a large potential that could be exploited in pharmaceutical and medical applications in many developing countries. Its application and diffusion in agriculture could permit the development of superior plant varieties with improved nutritional quality, thus providing opportunities for expanding export earnings and food production on a sustainable basis. New materials have many applications including construction, engineering and medicine; they could create more competition in markets previously dominated by such non-renewable resources as metals.

21. As well as influencing the structure of world trade, these changes are modifying the international division of labour and generating important consequences for the competitive position of developing countries in international trade. Micro-electronics-based innovations and new materials technologies are eroding the traditional comparative advantage of developing countries in labour and natural raw materials in several areas. They could have negative repercussions on the demand for several products of export interest to developing countries. Technological changes have tended to be disruptive for many developing economies owing to their inadequate diversification and their lower capacity to absorb and adjust to the new technologies. Differences in existing technological capabilities and in the ability to attract foreign investment and technology inflows could accentuate the industrial and technological polarization between developed and developing countries as well as among developing countries. It has become urgent for developing countries to attain, accommodate and manage higher levels of technological development so as to enhance their international competitiveness and to facilitate their access to new and buoyant areas in world trade.

22. Some broad conclusions emerge from this analysis. In some applications, the new technologies could, with adequate diffusion and adaptation, help countries to leapfrog certain stages of the industrial development process. They can contribute significantly to improving productivity and sustainability of resources in such areas as agricultural production, manufacturing, renewable energy generation and pollution control. More generally they should assist in translating into purposeful action the growing concern with environmentally sound and sustainable development. To take advantage of these possibilities, developing countries would have to give greater attention to human resource development, and to policies fostering the development, adoption and adaptation of technology. Such efforts would call for increased external assistance in research and development and in the strengthening of scientific and technological institutions. They would also call for increased technology flows, through foreign direct investment, imports of machinery and equipment, and licensing of patents. Improved access to technology on concessional terms, including new and advanced technology of critical importance to development, is vital.

C. Globalization and interdependence

23. Technological change has been instrumental also in speeding up the internationalization of a number of markets. The increasing deregulation of financial markets led to the emergence, facilitated by the development of electronic trading, of a huge global market for funds and financial instruments. International private financial flows grew spectacularly over the past two decades and have now attained levels several times in excess of the value of international merchandise trade. This evolution continues to have major implications for the behaviour of exchange rates and interest rates, and consequently for the relative competitiveness of economies. In addition, exchange rates have come to be determined more by expectations in financial markets than by the needs of trade adjustment.

24. Largely because of advances in information technologies, the 1980s saw the emergence of another layer of internationalization involving strategic alliances between transnational corporations and increased reliance on

worldwide information networks. This globalization process, as the phenomenon came to be described, made innovation, together with flexibility in the location of production, distribution, and service facilities, even more crucial for profitability. The trend is already pronounced in the services sector, particularly communications, transport and financial services, and has begun to reshuffle existing patterns of comparative advantage. One result is that a growing share of international trade now takes place within corporations or among related firms. In addition to their extensive control of distribution channels and information networks, such private mechanisms have acquired a dominant role in determining the global location of economic activities and access to new technologies. In consequence, they exert a considerable influence on the behaviour of the world economy.

25. These developments have given substantial impetus to the growth of interdependence in the world economy. Key sectors covering trade flows in goods and services and developments in areas of money, finance, debt and commodities, are now more closely integrated. Linkages among economies as well as trading entities have grown tighter. The world energy situation has come under greater influence from a wide variety of factors - environmental, technological and strategic as well as financial and commercial. The interactions between the domestic policies of governments, internationally accepted rules and disciplines and the operation of market processes have grown stronger and more diversified.

26. These phenomena have tended to erode the capacity of governments to determine the course of events and have tightened the constraints on the scope for autonomous policy-making in developing countries. They have also heightened the vulnerability of those economies, particularly in the developing world, that are open enough to come under considerable influence from abroad but are not sufficiently large for their own policies to make a significant impact on others. Thus, the volume and terms of trade of developing countries depends to an increasing degree on the overall stance of macroeconomic policies in major OECD countries. Likewise, the burden of developing-country debt is sharply affected by the mix of monetary and fiscal policies in the OECD countries through the effects of such policies on interest rates. This asymmetry of interdependence needs to be addressed so as to minimize the disproportionate strains it places on developing countries.

27. Reflecting the recent surge in ecological awareness throughout the world, the concept of sustainable development, which is explored in section G below, has given a new edge to interdependence both of key areas of economic policy and among economies and economic actors. The emphasis which sustainable development places on the interrelationships of economic, social and environmental phenomena has brought to the fore their potential - both positive and negative - for cumulative interaction worldwide. It accordingly underlines the imperative of cooperative approaches involving all countries.

28. Other phenomena have also thrown into stark relief the realities of interdependence. Trends in favour of the free movement of people and ideas around the world have grown stronger, while upheavals fuel the flow of refugees and international migrants into other countries. Epidemics have implications reaching beyond national frontiers and terrorism has been a source of international concern. The illicit traffic in narcotics links

social problems associated with relative affluence in the developed world to those arising from the relative poverty of developing countries whose commodity exports no longer provide adequate support.

D. Expanding economic spaces

29. Another major development in the world economy over the past few years has been the resurgence of interest in arrangements designed to integrate national economies in formal groupings centring on common markets, customs unions, or free-trade areas. The most visible instances are of course the coming into force of the Canada-United States Free Trade Agreement and the completion of the internal market of the European Community. The inclusion of Mexico in the Canada-United States free trade arrangements is under active discussion, and the Enterprise of the Americas initiative could extend the free-trade area to the whole of the continent.

30. Negotiations have also been under way for the extension of most of the provisions of the EC 92 programme to EFTA, and recently a number of EFTA countries have expressed interest in direct membership of the Community. A number of countries in Central and Eastern Europe have set themselves a similar goal and some of them are negotiating association agreements with the Community. In East Asia, comparable policy initiatives - notably the Malaysian proposal for an East Asian economic grouping - have not yet made substantial progress. Even so, there has been rapid growth of intra-Asian trade centred on Japan, and the de facto emergence of an investment-led trade grouping with Japan as its centre is a distinct possibility.

31. A number of other groupings in the African, Asian and Latin American regions are either evolving or in prospect. These involve efforts by developing countries, which are discussed in Part Two, Chapter II.C of this report, to enhance their economic cooperation and collective self-reliance at the subregional, regional and interregional levels. But it is the economic weight and political importance of integration arrangements involving major trading entities that has generated strong interest in their potential and legitimate concerns about their implications for the development process as well as for the world economy.

32. The likely effects of these major integration arrangements on the world trading system and on the trading interests of developing countries are so far uncertain. In principle, closer integration in both Europe and North America has the potential to strengthen the major economies and the capacity of the groupings concerned to support global economic growth if the process is accompanied by openness to the rest of the world. The removal of trade barriers within such groupings and the enhanced competition flowing therefrom should lead to improvements in efficiency and productivity. This should exert a positive influence on long-term internal growth, investment and income and should in turn generate higher demand for imports from the rest of the world. At the same time, the gains in efficiency within each grouping should reduce costs and lead to an increase in output, albeit at the expense of imports from non-participant countries. The trade-creating effects of higher incomes may, however exceed the trade-diverting effects of greater intraregional efficiency, provided no adverse changes occur in trade policies towards non-participants. Besides, the possibilities of these groupings evolving into

self-contained trade fortresses will be tempered by their considerable dependence on intraregional markets, as well as by the increased globalization of production processes which is discussed in the preceding section.

33. At first sight, therefore, these prospects should not give rise to concern. Several countries could indeed benefit substantially from these arrangements. For example, the closer integration of countries in Central and Eastern Europe with the rest of Europe could boost their recovery, with favourable long-term effects on their imports from developing countries. Similarly, considerable benefits could accrue to Latin American countries from an enlargement of the Canada-United States free trade area, although these benefits would be maximized if the final arrangements also promoted free trade among the former countries.

34. In practice, however, arrangements involving major trading countries and entailing common trade policies are likely to have other consequences unless barriers towards non-participants are concurrently reduced. The effects of limiting preferential market access to participants are bound to influence the patterns of growth of international trade and specialization, and consequently of foreign direct investment in ways that do not necessarily correspond to long-term comparative advantage or to development needs. They therefore pose a variety of difficult policy choices for non-participants. In addition, the process of integrating economies at varying levels of development and with differing structures poses other risks: it could give rise to temptations to use trade control measures as a means of shifting to third parties the burden of adjustment falling on the less advanced partners. Furthermore, such integration arrangements could increase the potential for trade disputes and raise trade tensions. If they were to promote greater reliance on bilateral or plurilateral processes for trade liberalization, they might well undermine the integrity and weaken the disciplines of the multilateral trading system.

35. Certain features of these arrangements address a number of trade related issues that have acquired salience over the past several years. They include such subjects as foreign direct investment and trade in services, including movement of labour, where multilateral instruments do not yet exist. They also provide for greater disciplines than are available in the multilateral framework on voluntary export restraints, and countervailing and anti-dumping measures. This experience must not be allowed to serve as a stumbling block to a global compact on trade that fully respects the needs of the developing countries. Rather it should be used as a building block to improve the multilateral trading system and thereby to translate into firm disciplines the wider ranging global consensus underpinning the Uruguay Round.

36. The international community still has an opportunity through the Uruguay Round to avert the potentially negative effects of these major integration groupings on the world trading system. Serious note must, of course, be taken of repeated assurances by the countries concerned that these groupings, far from being inward-looking, would contribute to a more dynamic and open trading system. But such assurances can be effectively fulfilled only if the Uruguay Round yields a positive and balanced outcome. Such an outcome must entail, inter alia, improved overall market access for developing countries and strengthened multilateral principles, rules and disciplines which impart greater openness and predictability to the system and take the

development dimension fully into account. It should also ward off possible trends towards fragmentation by anchoring such integration arrangements firmly within the system and ensuring that they do not raise barriers to the trade of third countries. Meanwhile, the key participants can help assuage concerns of developing and other trading countries about access by forestalling, through vigorous monitoring and review, emerging impediments in the way of access to their markets.

E. Growing diversity in development

37. Aggregates concerning world output and international trade since the recession of the early 1980s mask the diversity of growth experience as well as the economic stagnation in which most developing countries have been trapped. Although many are pursuing major policy reforms, often prescribed by international financial institutions, progress has been fragile and uneven. For a sizeable number of them, including least developed countries, the possibility still looms of further marginalization in the world economy. Their problems of poverty and deprivation have deepened, and the attendant risks of social unrest and political destabilization have increased. In Latin America the annual rate of growth declined from 5.5 per cent in the 1970s to just over 1 per cent in the 1980s; in Africa it fell from about 5 per cent to less than 1 per cent, and there was also a large decline in West Asia.

38. At the same time, economic performance in several countries, including some of the biggest and the poorest in the developing world, showed considerable dynamism. In particular, China and India continued to grow at a vigorous pace. So did the industrializing East and South-East Asian economies, in most cases at rates exceeding 7 per cent per annum in the 1980s. A common ingredient in the experience of the latter group of economies was outward orientation together with a rapid expansion of manufactured output. High levels of investment, including private foreign investment and associated flows of technology, facilitated this achievement. Even so, there were considerable variations in the economic strategies and policy instruments applied by these countries. Growth rates also differed among countries at the same level of development. Some middle-income countries showed fast growth while others declined; likewise, some low-income countries grew while the majority stagnated or declined, most least developed countries among them.

39. This diversity of experiences has been taken as evidence that the principal determinant of success or failure is not the external environment - which is in principle common to all countries - but rather the domestic policies pursued, including the quality and speed of adjustment. The real picture is, however, a complex one. Given the evolution of the external environment, the principal factors that accounted for differential economic performance among developing countries in the 1980s were the initial conditions (which were in part due to past policies), domestic structural factors, the incidence of external shocks, and the policy responses of countries. The impact of external shocks depended on the type and degree of exposure to external trade and finance, in particular the size and structure of their trade and debt. Countries also differed in their underlying potential for adjustment owing to differences in the size and diversity of the tradeable goods sectors and the level of income, consumption and investment,

as well as overall size, natural resource base and population. The timeliness and adequacy of the policy responses of developing countries naturally had a significant influence on the extent to which they were able to cope with external factors affecting their economic performance.

40. As the worldwide recession of the early 1980s abated, the transmission mechanisms of growth at the international level were frustrated by domestic recessionary adjustment and macroeconomic disorder in the domestic economies of many developing countries, notably the debt-distressed. But the negative dynamics at work in the world economy played the crucial role in this regard. In particular, the shift in policy priorities that occurred in OECD countries during the 1980s, including the relative roles of monetary and fiscal policy, impeded the emergence of strong links between expansion in their economies and foreign exchange availabilities in developing countries. Furthermore, major features of the international economic environment which are of critical importance for the development process in most developing countries remained generally unsupportive of their efforts.

41. These features are examined later in this report, but they include the dramatic decline in the real prices of non-petroleum commodity exports from developing countries - amounting to some 40 per cent between 1980 and 1988 - and in the terms of trade of these countries. The impact was compounded by the collapse in financial flows, the burden of the debt overhang, itself partly the result of the sharp fall in commodity prices, and the rise in international interest rates. Formidable barriers in developed-country markets were also an important contributing factor. These developments explain the simultaneous reversal of the economic fortunes of so many countries in the 1980s, encompassing both a sharp fall in the number of success stories and a rise in the proportion of set-backs and failures. The evidence amply demonstrates that for most developing countries sound domestic policies have little chance of succeeding over time without a facilitating external economic environment and supportive international actions.

F. Demographic trends

42. Population growth and fertility are increasingly critical issues for the sustainability of the development process. New population projections suggest that, while growing at a declining rate, the world's population, barring devastating pandemics, will double by around the middle of the twenty-first century. More than four fifths will be found in the developing world. These predictions have given added weight to the importance of improved population programmes and their integration into development strategies and policies. There is a gathering consensus that womens' education, improved maternity and child-care services and appropriate family planning services demand higher priority. For the first time, targets in fertility and family planning have been incorporated in international development strategies.

43. Attendant changes in the age structure of populations - involving broadly an increase in the size of the youth population in developing countries and in the proportion of the elderly in most countries - will compound the serious problems of savings mobilization and resource allocation posed by population growth. In developing countries the resulting pressures on employment creation, education and training, and social services will be especially

heavy. These trends represent a major human dimension of the challenge of sound and ecologically sustainable development, which is examined in a later section.

44. A related demographic trend is that of migration, a deep-rooted historical phenomenon which is evolving with changes in social and economic situations and in transport and communications systems. Over the past several decades, most migration in the developing world has taken place within national boundaries, in the form of urban drift, or among neighbouring countries, in the form of refugee movements. But emigration in search of employment in rich countries - industrialized or petroleum-exporting - has been growing and is for many labour-exporting countries a valuable source of remittance income. The movement of labour has surfaced in the context of negotiations on trade in services in the Uruguay Round.

45. International emigration from developing countries has been causing increasing concern in both originating and receiving countries, including those in the developed regions. This phenomenon has disquieting implications in that it constitutes an outflow of productive resources including skills, knowledge and entrepreneurship important for the development of originating countries. In receiving countries, difficulties of absorption, housing and employment can be expected to mount. These concerns may well be compounded by migration from Central and East European countries if difficulties persist in their market-based reform processes.

46. Governments have been responding to urban drift by adopting more geographically-balanced development policies, including labour-intensive employment creation, especially in rural areas. Similarly, the time is ripe for initiatives to evolve an orderly framework for international migration. Incentive policies in countries of origin would help retain skilled personnel or induce their return from abroad. Current efforts by developed countries to cope with immigration pressures must be based on respect for the human rights of immigrants and on avowed commitments to foster free and open societies. In the long run, the central objective must be to reduce the motivation to emigrate, through deliberate international action in favour of sustainable economic development worldwide.

G. The new challenge of sustainable development

47. Recent years have seen a sharp rise in the level of concern for the health of the global environment and for the long-term security of the planet's ecology base. The world community is increasingly conscious that natural resources must be wisely managed in the interests of present and future generations. A better understanding is emerging of the potentially beneficial interactions between ecology and economy, which promises to allay the fear that environmental protection must be at the expense of growth and development. The concept of sustainable development seeks to place environmental concerns firmly within the context of growth, and the discussion now reaches beyond limiting practices and products which harm the environment. It encompasses such topics as patterns of economic activity which are at the root of ecological damage, the persistence of poverty, the quality of development, and the necessary adaptation of domestic and international economic management.

48. It remains to translate that concept into reality, by devising means to ensure, among other things, that wealth does not continue to generate waste of natural resources and that poverty is steadily eliminated as a source of their degradation. The growth models so far pursued by industrial countries cannot be adopted by the entire world community, present and projected, without acute strain on the carrying capacity of the global ecology. Sustainable development calls for change in these models, not for putting a hold on the development process. This would be unacceptable while a large part of the world's population continued to live in conditions of severe material deprivation and unsatisfied basic needs. If development is regarded as a multifaceted process having economic, social and ecological dimensions, and aimed at enhancing human welfare, then the real contradiction is between environmental concerns and the content of certain patterns of economic growth. This conflict can arise both in relation to the global environment, as in the case of ozone depletion and the greenhouse effect, or to the local environment as with urban pollution and soil degradation.

49. In a wide variety of circumstances, the operation of free markets can be expected to produce a reasonable equivalence between the social opportunity cost of output and the social welfare derived from consuming that output: both economic efficiency and welfare are thus maximized. However, environmental economic analysis reveals important instances in which markets left to themselves will not produce this outcome. Shortcomings will occur whenever the full social cost of production is not borne by the producer, or the full social benefits of consumption realized by purchasers of the output. Dealing with such market failures may call for incentive systems and regulatory measures which would oblige individual producers and consumers to take full account of the social costs and benefits and, on the basis of this accounting, would allow markets to function.

50. Considerations of equity as well as efficiency in the pursuit of sustainable development underscore the need to pay particular attention to income-reducing effects that may arise from environmental measures. International cooperation would have to ensure that any such effects of measures to address global environmental problems are not borne by those countries least able to withstand them. It should be borne in mind that the depletion that has occurred in the stock of certain forms of global environmental capital is the result of decades of industrialization. The burden of replenishing and sustaining this capital should be so shared as not to hamper the development process of countries that have so far remained outside the mainstream of industrialization. Appropriate financial and other incentives will be required to foster action by developing countries to preserve their natural capital stock for the benefit of all.

51. Giving effect to sustainable development will thus require far-reaching changes in macro- and micro-economic policies, including the deployment of policy measures of various types to conserve national and global resources in a manner conducive to the development process. As well as a reassessment of hitherto accepted consumption patterns and lifestyles in industrial countries, vigorous international cooperation will be needed to promote the development and transfer of environmentally sound technologies, together with substantial additional resource flows to developing countries and the elimination of trade

barriers. In view of the steady globalization of ecological problems, the conclusion is inescapable that only concerted international action can set in motion appropriate policies towards sustainable development and the proper sharing of the corresponding costs and benefits.

52. The challenges are immense. The development of environmentally sound technology for instance is likely to produce the next wave of technological innovation, with its principal source lying in the industrial countries. These countries have a strong interest, beyond purely commercial considerations, in the dissemination of such technologies to the developing world. They recognize - as illustrated by recent initiatives aimed at protecting the ozone layer and at limiting climate change - that global environmental problems can be solved only with the participation of the developing countries. Yet, the risks are already becoming apparent: the risk of development financing being made conditional on the adoption of such technologies but without the inclusion of additional resources for that purpose, and the risk of a further widening of the technological gap between developed and the developing countries.

53. In this and several other respects, ecologically sound and sustainable development constitutes a vast field for national and international endeavour in which a determined attack on poverty must be central. Many of the essential challenges it presents call for international discussion and negotiation involving the full participation of all countries. This is particularly important where solutions are indeterminate in formal economic theory or where externalities need to be internalized and responsibilities assigned for the protection and management of the assets of nature. Indeed sustainable development provides substantially greater scope for all countries, developed as well as developing, to pursue many of their vital interests in the context of the development dialogue. It thus offers opportunities unprecedented in recent years, even though fraught with difficulty, for strengthening international economic cooperation for development.

Chapter II

THE LEGACY OF THE 1980s

54. The structural changes and other trends examined in Part One, Chapter I, have considerably modified the context for the pursuit of effective strategies to promote ecologically sustainable growth in the world economy and accelerated development in the developing countries. In essence, however, the problems that need to be addressed remain unchanged. They include the continuing disarray in the development process, the mixed performance of structural adjustment efforts, the persistence of poverty and deprivation, the unfavourable evolution of the international economic and policy environment, and the insufficient commitment of countries to cooperative action for a healthy, secure and equitable world economy.

A. The development process and structural adjustment

55. The 1980s saw the most serious setback to the development process for more than three decades. More than two thirds of the developing countries experienced a decline in per capita incomes during the decade; in more than half of these countries the decline exceeded 10 per cent and in two out of five it was over 20 per cent. Associated with this evolution were widespread reductions of employment, falls in production and investment, and adverse effects on efforts to improve technological capabilities. In such cases, cuts in imported inputs and declining foreign direct investment played an important role. The reductions in investments in productive capacity and infrastructure weakened the ability of developing countries to achieve the changes in economic structures required for sustained growth and to meet the future needs their populations. Contributing to this trend was the decline of such major influences on human development as nutrition and expenditures on health and education.

56. As indicated in Chapter I, section E, not all developing countries suffered from adverse changes of this magnitude. Several enjoyed per capita income growth of 1 per cent or more during the decade and indeed vigorous growth continued in a number of countries in South and South-East Asia, including some major exporters of manufactures. These countries showed considerable variation in their patterns of social development as well as in the major characteristics of their economies.

57. The persistence and spread of poverty in the developing world remained the most pressing human aspect of the evolution just described. By the end of the decade, the gap in living standards between developing countries and the rest of the world had widened further, as had disparities among different parts of the developing world. By the end of the 1980s, average per capita income in the least developed countries was one seventieth of that of the developed market-economy countries and one fourth of that of developing countries as a group. The number of people in developing countries living below the poverty line had risen to 1.2 billion, representing over one fourth of the population of the developing world. While substantial increases in these numbers were recorded in Latin America, some 40 per cent were to be found in Asia and on present trends the share of Africa could attain a similar magnitude by the end of the 1990s.

58. Per capita income figures obscure the evolution of poverty, poor living standards and inequalities within countries as well as its disproportionate burden on women, children and rural populations. The evidence is that in countries enjoying rising income, social conditions generally improved and the proportion of the absolute poor in the population fell. In most developing countries, however, declining per capita income was accompanied by falling living standards and a substantial increase in the numbers of the poor. The least developed countries were the worst affected: some two thirds of their total population remained illiterate, one child in five failed to reach the age of five, and only one person in ten had access to safe drinking water.

59. Under the pressure of budgetary and balance-of-payments difficulties, a large number of developing countries undertook far-reaching policy reforms during the decade. The objective was to adapt productive systems and improve physical and institutional infrastructures in response to shocks and other changes in the external economic environment. Supported, typically, by the International Monetary Fund and the World Bank within their respective spheres of operations, the reforms were expected to restore macroeconomic balance, increase the efficiency of resource use, and create conditions for sustainable growth.

60. With a view to macroeconomic balance, the effort was to bring the level of demand and its composition into line with the level of output and the foreseeable flow of external financing. Substantial reductions in the public sector deficit were also seen as necessary to bring down high inflation and the external deficit. Efficiency and growth objectives were pursued through creating appropriate incentives, removing constraints on factor mobility, and promoting saving and investment. These policy shifts implied, inter alia, strengthening the market orientation of the economy, expanding the role of the private sector and reducing that of the public sector, and liberalizing imports. More recently, attempts have been made to supplement these efforts by programmes of training, credit and employment, as well as compensatory schemes targeted at vulnerable groups.

61. Evaluating the effects of such structural adjustment programmes is fraught with methodological problems. Divergencies of view also persist as to how best to take account of the effects of initial conditions, external shocks and the availability of external financing. The experience so far suggests that macroeconomic policies adopted in the context of these programmes, particularly demand deflation, financial austerity, and currency devaluation, promoted improvement in the trade balances of many countries, notably in Latin America where sharp import compression was combined with substantial export expansion. In a number of these countries stricter financial controls helped to reduce inflation rates, and facilitated progress towards external payments balance, including meeting debt-service obligations.

62. At the same time, compelling evidence has accumulated of the substantially negative impact of these programmes on investment, private and public, which is at the heart of the development process. Many of the countries following such programmes suffered declines in output and employment, as well as per capita incomes associated with the reductions in consumption and investment regarded as necessary to restore macroeconomic balance. They also had great difficulty in reconciling their debt-service

obligations with the restructuring of their economies required for future economic growth. Over and above the disproportionate impact of such declines on poor and vulnerable groups, the share of government expenditure in the social sector, including health, nutrition and education, also fell.

63. Not only has the process of adjustment as pursued not been compatible with growth in a large number of countries, but adjusting to the deterioration in the balance of payment through, for instance, import cuts and currency devaluations also caused considerable fiscal damage. Policies in these areas worked directly to raise budget expenditures and reduce revenues, and the typical reaction was to cut expenditures other than interest payments on debt and to increase charges for goods and services. But when the social and political limits to this kind of response were reached, the result was a rapid increase in domestic debt and/or monetization of the remaining budget deficit. This in turn set in motion forces that made the budget even more difficult to control. The consequent financial disorder rendered inadequate policy prescriptions that would have sufficed in less abnormal times. It also clouded the prospects of relieving the external resource constraint and of the adjustment process itself.

64. An inherent contradiction is thus evident in programmes which aim to lay a basis for renewed growth by incorporating policies which reduce flexibility in the domestic economy, including the capacity to cope with unforeseen external changes, and which frequently trigger macroeconomic disorder. Furthermore, in debtor developing countries, measures to encourage higher domestic savings, such as raising the level of real interest rates, may be nullified if the additional savings are used to pay interest on the external debt rather than to finance new investment. For many countries, a substantial growth in savings, both public and private, is largely contingent on expanded export earnings and hence on improvement in the international economic environment. Besides, sharp cuts in health, education and other expenditures on human development which are essential to long-term economic growth also serve to lower the living standards of the poorer strata of the population. Such developments carry risks of social and political instability and of the increased degradation of the natural environment that poverty is apt to promote.

65. The correction of a balance-of-payments deficit does not have to involve a reduction of aggregate demand. Adjustment is not impossible in the context of rising demand and output, provided among other things that the share of output allocated to exports increases or the import content of output decreases. Moreover, implications for international economic policy arise where deflationary measures are applied in surplus and deficit countries alike as a means of combating inflation, and in the latter countries also as a means of reducing external imbalance. Efforts by deficit countries to restore external balance by increasing exports may well be frustrated by the simultaneous decline in import demand of the surplus countries. In addition, the various downward pressures on world demand generated by these measures could, reinforcing one another, add to recessionary influences on the world economy.

66. Some progress has been registered in international understanding of adjustment processes and of the nature of the difficulties indicated above. Useful lessons are being learnt from experience, the application of which could assist current efforts to improve the design, content and duration of adjustment programmes, including the sequencing of policy reforms. There is stronger recognition too that the objective of adjustment with growth requires greater flows of external resources and should be underpinned by debt and debt service reduction as a central element. Important initiatives are being pursued and some new ones are under active discussion. Yet, as will be discussed in Part Three, Chapter I resource flows have been far from adequate and current approaches to the commercial bank, official and multilateral debt of developing countries need strengthening in several respects.

B. The external economic environment for development

67. The deterioration of the financial and trading positions of most developing countries during the 1980s was closely related to an external economic environment for development that was markedly more unfavourable than in the preceding two decades. As already indicated, the outstanding characteristics of this environment were a collapse of financial flows, higher international interest rates, depressed commodity prices and increased levels of protectionism in the OECD area, as well as a steady retreat from multilateralism in favour of unilateral and bilateral approaches in international trade relations.

68. For most debtor developing countries the external payments situation has yet to show sustained improvement. Debt to export ratios have improved somewhat but are still above 1982 levels. Ratios of interest payment to exports remained high partly because of the rise in international interest rates in relation to the prices of developing-country exports. Official development finance and export credit flows to developing countries stagnated and new flows of external finance from private sources dwindled. In 1989, bank lending to developing countries with debt-service difficulties was less than one fifth of the 1984 level, and in recent years arrears continued to mount for many debtors. Since the onset of the debt crisis indebted developing countries as a group have had to transfer abroad financial resources amounting to some 2-3 per cent of their GDP, and in some instances this burden exceeded 6 per cent. For many of them this reflected outward net financial flows over the period beginning 1983.

69. These external financial constraints on the development process were accentuated for most developing countries by worsening terms of trade. Except for occasional short-lived periods of boom, conditions in international commodity markets over the past 20 years have been unfavourable for countries depending on commodity exports for the bulk of their foreign exchange earnings. The declining trend of the real prices of developing-country commodity exports that had been evident since 1970 became sharper in the 1980s. Despite a considerable expansion in the volume of non-petroleum commodity exports by developing countries as a group, their terms of trade weakened substantially. For African countries, the coincidence of declining export volumes and depressed prices led to earnings losses of about one third during the decade. For the least developed countries, the terms of trade declined by over 20 per cent. Owing to falls in export earnings and the unavailability of

external financing, policy-making in a very large number of developing countries came to be dominated by shortages of foreign exchange. For many of them the overhang of external debt remained an impediment to enhanced access to international lending and a revival of their imports.

70. Developments in the field of international trade were negative for most developing countries. Protectionist pressures mounted and trade tensions remained high throughout the period along with a proliferation of trade barriers, particularly against exports of manufactures. Many took the form of voluntary export restraints and other bilateral arrangements, almost all of which were discriminatory. The multilateral trading system, conceived as an arrangement based on the principles of transparency and non-discrimination, continued to be eroded. Growing tendencies towards managed trade were accompanied by increasing reliance on the exercise of economic weight rather than the observance of agreed rules. As explained in Part One, Chapter ID, the emergence of regional trading arrangements involving major trading partners raised uncertainties about market access and trading possibilicies for developing countries.

71. The worsening of the external economic environment for development took place in the context of a longer-term increase in the unpredictability of key economic variables including exchange rates, interest rates, commodity prices and levels of production. This volatility made it difficult for developing countries to plan the external sectors of their economies and to manage their international debt-servicing obligations in a rational manner. It put at risk the stable flow of imports of both capital and intermediate goods that most developing economies at a low level of diversification needed to maintain current levels of output. Moreover, the formulation of rational medium- to long-term development strategies was complicated by the lack of international market indicators that are free from wide short-term fluctuations.

72. The problem of depressed commodity prices and their instability was compounded by fluctuations in activity in major industrial countries. It was also aggravated by the repercussions of exchange rate volatility in primary commodity markets. The strategies of commodity-dependent countries for diversifying their economies and for increasing manufactured exports thus had to be planned and implemented in adverse circumstances. Uncertainties arising from the frequent introduction of new and discriminatory protectionist barriers complicated both short- and longer-term policy-making.

73. Also as a result of greater exchange rate instability, the costs of external trade rose for all groups of countries, particularly those to which risk reducing instruments were not readily available. Such instability also compounded the debt problem of developing countries both through its impact on interest rates and, more directly, to the extent that the currency composition of debt diverged from that of foreign exchange earnings and reserves. Upward swings in average interest rates coupled with terms of trade deterioration reduced the import capacity of debtor countries, especially those with high debt export ratios. The pressure on countries to expand exports intensified, despite the prospect, in the case of commodities, of further terms of trade deterioration or, as regards manufactures, of stiff protectionist reactions.

74. Structural adaptation and growth in developing countries, which was examined earlier, are integral parts of growth and adjustment on a global scale. The present international adjustment process provides for effective pressure to be brought to bear on debtor developing countries to adjust. But no comparable pressure can yet be exerted on creditor countries either to expand their rates of economic growth and promote structural change in their own economies or to recycle their surpluses when available to deficit countries. Responses in development market economies to the need for structural change tended to be defensive and to resist the current of fundamental market forces. This asymmetry, together with increased protectionism in OECD markets, as well as high real interest rates and depressed commodity prices, constitutes a major reason for the disproportionate burden of global adjustment on the developing countries in the 1980s.

C. The state of multilateral economic cooperation for development

75. Another feature of the 1980s was the weakening of commitment to multilateral approaches to key issues affecting development cooperation. The earlier consensus that the international community has a collective responsibility for the development of the third world and that international cooperation has a central role to play in this process continued to wither. This evolution largely reflected the view that recent economic difficulties were the result primarily of inappropriate policies at the national level, in both developed and developing countries. On this view, the solution to current difficulties must involve, in the first instance, the reduction or elimination of fiscal deficits and the adoption of sound monetary policies. This step was to be followed by structural adjustment designed to increase the flexibility of economies and improve the efficient use of resources through reliance on market mechanisms. As for international economic cooperation, the emphasis shifted to adjusting national economies to changes in external variables and to "putting one's own house in order".

76. Similarly, the development issue was viewed much less in terms of improving the external financial and trading environment, and more as a matter of improving allocative efficiency through structural reforms designed to provide incentives for the private sector to be the driving force for development. There was the perception also that many of the past efforts based on multilateral cooperation had fallen short of expectations. This disappointment applied, for instance, to the current state of commodity markets despite cooperative attempts at price stabilization. The mixed results of some development aid programmes also discouraged several donor countries. Furthermore, the regime of floating rates for the major trading currencies had failed to enhance the policy autonomy of Governments, while removing the mechanisms for policy dialogue previously provided by the Bretton Woods system. In addition, the persistence of unemployment and trade imbalances provided justification for the slow pace of the structural adjustment in major industrial countries.

77. A strong current of opinion in some industrial countries held that the complexities of an interdependent world economy had become so great that Governments, even acting collectively, should not seek to determine its evolution. Be that as it may, a number of structural and institutional

changes had been under way in the world economy which increased the difficulties of a multilateral approach. The emergence of additional centres of economic power also complicated the adoption of agreed multilateral policies. Multilateralism yielded ground to arrangements between major countries as well as to unilateral action and bilateral pressures, and all too often the domestic interests of individual countries prevailed over international considerations and collective benefit. Finally, several developments, as already discussed heightened the relative influence of private markets in the global economy, and reduced the efficiency of national macroeconomic policies.

78. These considerations are sober reminders of the difficulties and limitations of international cooperation in the current world economic situation. Over the past few years, however, the imperatives of multilateralism have been strengthened by the growing integration of the world economy and by an accumulation of such major developments as the rise in the level of ecological concern, the ascendancy of new technologies, changing perceptions of international economic policy and the political and economic transformations described earlier. International recognition of this reality has begun to take shape in multilateral forums.

79. A major theme of the Final Act of UNCTAD VII, for instance was that of mutual benefit, common interest, equity, non-discrimination and collective responsibility as the basis for instilling new strength into multilateral cooperation to revitalize development, growth and international trade. Likewise, the Declaration adopted by the Trade and Development Board and endorsed by the General Assembly in late 1989 on the occasion of the twenty-fifth anniversary of UNCTAD recognized the urgent need for concerted national and multilateral action to attack the obstacles to a healthy, secure and equitable world economy. Subsequently, in the Declaration on international economic cooperation and development adopted by the General Assembly at its special session in May 1990, States Members pledged themselves to advance the multilateral dialogue and to pursue international cooperation in response to the challenge of growth and development.

80. These declarations are welcome signs that the retreat from multilateralism may have come to a halt. Taken together, they represent a broad commitment by countries to promote international economic cooperation for sustained growth in the world economy and in particular to the revitalization of economic growth and development of developing countries. The Programme of Action adopted by the Second United Nations Conference on the Least Developed Countries, which was based on the concept of strengthened partnership between those countries and the developed countries, was a helpful signal. It may be construed as an initial, if context-specific, illustration of the seriousness with which these countries regard the broad commitments mentioned above. Giving effect to them, however, will require the formulation, and, no less important, the implementation of specific policies and measures on a much wider range of issues.

81. A key question is whether global processes and institutions will evolve in a manner that will enhance the management of interdependence and promote a more predictable and equitable functioning of the world economy. Multilateral cooperation is, of course, essential for this purpose. It calls for the

establishment or strengthening of norms and rules, particularly in the realms of trade, money and finance, which reduce the scope for abrupt and, from a global perspective, counter-productive policy change. Such rules should apply with the same rigour to the strong as they do to the weak. Forums for dialogue and consultation would have to be made more effective through the full involvement of countries, developing and otherwise, whose interests are overshadowed by those of major countries. In addition, the machinery for multilateral negotiations will need to be strengthened to enable them to deal with issues of global concern and the management of interdependence as well as international economic conflicts.

82. In the longer run, the potentials and risks described in Part One, Chapter I of the present report, including their implications for world peace and security, can be expected to work against any tendencies to allow the multitude of problems that have thus far accumulated to fester. But hard-headed calculations of long-run self-interest on the part of major industrial countries, as well as considerations of common interest and mutual benefit, will, it is to be hoped, prompt the early renewal of multilateral efforts that is so urgently needed.

Part Two

BROAD POLICY REPONSES

Chapter I

MARKET FORCES, PUBLIC POLICY AND GOOD MANAGEMENT

83. Recent developments, including the growing reliance on market forces as the primary means for organizing economic activity and for decentralizing decision-making, have focused renewed attention on the role, scope and character of public policy in the economic sphere. Against this background the theme of good governance has been introduced into the development dialogue in some multilateral forums. 2/ Parallel to this initiative, the concept of "good management" has been included as a dimension of the agenda of UNCTAD VIII. Divergences of view persist as to its precise scope and meaning, but in the context of the agenda the concept implies the formulation of objectives and rules for the promotion and implementation of efficient, socially equitable and ecologically sound public policies. It can be described in terms of the sum total of governmental and intergovernmental activities that define the framework, limits and rules of the game to orient the operation of markets and to provide a healthy climate for economic activity.

84. The context of the agenda also suggests that the domestic and international aspects of the concept are intertwined, with improvements in international management being influenced by better management at the national level and vice versa. At the national level, approaches to good management are bound to be defined by a wide variety of historical, cultural, social, and political factors. They must also take into account differences in levels of development, economic strategies, the capacity and coherence of governmental structures, the commitment of the political leadership and domestically acceptable relationships between the State and the various economic agents. Unlike national systems, sound international management can be buttressed only by agreed rules and disciplines based on common interest, mutual benefit and collective responsibility. Some pertinent issue areas are sketched below; their international aspects while mentioned are explored in greater detail elsewhere in the relevant sections of the present report.

A. Establishing a predictable framework

85. A predictable framework is essential for private sector activity, not least in order to reduce the uncertainties surrounding investment decisions, which are at the centre of growth. This purpose requires governmental action to improve and enlarge the physical and social infrastructure, to promote the basic human capacities and skills required to support economic activity, and to pursue sound macroeconomic policies. It also requires legal and regulatory frameworks defining with reasonable clarity what is and is not allowable, together with transparent processes for rule setting and efficient institutions for sound public administration.

86. These mechanisms should not involve bureaucratization beyond the minimum required, and should not be subject to ad hoc or arbitrary intervention by the politically powerful, or provide for such wide discretionary powers as would offer scope for improper practices by economic agents and their interlocutors in public office. Similar standards of transparency and accountability would have to prevail in the private sector. The efforts of developing countries in this direction would be more effective if the enterprise sector and public authorities in the developed world gave full effect to the same norms.

87. In the realm of international economic relations, the counterpart of these requirements includes a fully articulated regime for international trade based on agreed multilateral rules. It also implies the need for stable growth-oriented international environment for national policy-making and for the exploitation of market opportunities. Furthermore, it calls for effective macroeconomic policy coordination among major industrial countries and for broader participation by countries in international decision-making processes.

B. Managing conflict

88. As decentralization of economic activity leads to a proliferation of sources of social and economic conflict, good management should provide for mechanisms to promote constructive compromises and otherwise to resolve conflict among divergent interests. One prerequisite is that the economically strong should not be exempt from rules and procedures applicable to all and that in this area as elsewhere processes for the settlement of disputes should be transparent. This requirement entails the development or reinforcement of systems of dispute settlement and conflict resolution, including at the national level an appropriate role for courts of law supported by guarantees for the independence of the judiciary.

89. At the international level, it calls, among other things, for the strengthening of mechanisms for the settlement of disputes relating to trade investment and intellectual property, as well as to transboundary environmental pollution. Rules and disciplines in these areas must be firmly founded on international consensus, and should not be circumvented by recourse to bilateral and plurilateral arrangements or to the application of economic weight.

C. Dealing with market deficiencies

90. In a reasonably stable macroeconomic environment, markets are the most efficient means of organizing decentralized activity and promoting welfare. However, when there are major departures from full employment and capacity utilization, market signals may be ambiguous indicators for the allocation of resources. As markets operate in specific social, historical and cultural contexts, judgements on the significance and extent of market deficiencies will vary among countries. Nevertheless, certain problem areas which may call for public intervention can be identified.

91. One is the incidence of rents, where a concentration of market power in a small number of firms combined with a lack of competition leads to prices exceeding the competitive price, thus producing excess earnings. Public intervention in such situations should aim at fostering competition, but in

such a way as to avoid eliminating the industry. Such intervention should not itself create rents unless this is a specific policy objective. Another type of situation widely recognized as justifying selective policy intervention arises when nascent industries need time to develop a competitive edge. Most industrial countries have passed through a phase of infant industry protection, and the policies of the best, as well as some of the worst, growth performers among developing countries have been characterized by such intervention. Experience shows, however, that the costs of policy mistakes can be high and underlines the need for caution.

92. Without adequate political intervention the operation of market forces may compound problems of poverty and inequitable income distribution to an extent incompatible with prevailing societal values. For reasons not fully within their control, many economic actors as well as poor and vulnerable groups are not able to exploit market opportunities to achieve minimal income levels. Social and political cohesion accordingly requires public policy to address questions of income distribution, at least by putting economic safety nets in place and assisting disadvantaged groups to gain access to market opportunities.

93. Similarly, the consistent inability of markets to deal with the phenomena of externalities and public goods implies that, left to their own devices, they cannot ensure the environmental sustainability of economic activity. Yet, because of the great complexity of the problems involved, decentralized responsibility and decision-making militates in favour of using market-related mechanisms to the greatest extent possible. Public policy should, inter alia, include the creation of incentives for sound resource management and the integration of environmental considerations into economic policy.

94. The international dimensions of the foregoing discussion are reflected in the relevant sections of this report. In brief, the obstacles to a healthy and equitable world economy will not be overcome by spontaneous economic forces alone. Nor are international market failures or distortions self-correcting. At the international no less than the national level, access to opportunities for the generation of wealth and income will need to be broadened; a framework of rules and cooperative arrangements based on consensus is essential for this purpose and this entails stronger international cooperation. This principle has several implications for multilateral action on, for example, concessional flows to less advantaged countries, the proper functioning of international markets, and special and differential treatment for the trade of weaker trading partners. No less important, multilateral approaches involving all governments are indispensable for managing the global commons and shared resources, and for ensuring that economic activities are ecologically sustainable.

D. Governmental involvement in economic activity

95. The role of government is thus essential for a number of purposes. These include putting in place basic infrastructures, establishing appropriate policy environments including well-functioning rules and institutions for the efficient management of resources. They also include creating conditions for the effective functioning of markets, stimulating the development of

entrepreneurship and promoting or undertaking, as necessary, some functions which cannot for reasons of scale or externality be adequately initiated by the private enterprise sector.

96. Questions remain, however, about the desirable extent of direct governmental involvement in economic activity and as to the types of policy measures to be deployed in that regard. While market-oriented policy reforms can be expected in principle to limit the boundaries of official intervention, in practice they often alter, and in particular sectors may even increase, demands on public institutions. Thus, for instance, the liberalization of financial markets may well call for the creation of regulatory bodies to protect the interests of investors and depositors.

97. Bringing about conditions supportive of entrepreneurial dynamism, creativity and innovation also require governmental initiatives. So does the need to define appropriate regulatory frameworks for the activities of transnational as well as national corporations, to curb the spread of restrictive business practices, and to foster competition. Similarly, because uncertainty and externalities are integral to research and development, public authorities have a role to play in promoting appropriate institutions, private as well as public, and capabilities in the field of technology.

98. The diversity of country situations will remain a major influence on choices affecting the balance to be maintained between the public and private enterprise sectors. But the comparative advantage approach has a great deal to commend it - at least where there is the necessary social consensus about objectives. That is to say, the costs of possible intervention should be carefully weighed against the benefits, and the importance of each sector should be determined as an outcome of its relative efficiency. A key consideration is that the extent to which governmental interventions work with and through market forces is no less significant than their scope.

99. Privatization is a policy option being actively pursued in many countries, partly out of a political preference for smaller government and for private property ownership, but also out of a concern to improve overall economic performance. In the developing world privatization has typically been driven by fiscal pressure, as a necessary part of the task of reducing budget deficits in the context of balance-of-payments adjustment processes. Privatization substitutes the straightforward criterion of the market-place for the multiple objectives of the public enterprise, but need not preclude the pursuit of these objectives in other contexts. Privatization can be expected among other things to promote increased attention to price signals and financial disciplines, thus providing an incentive to keep down production costs. Even so, the degree of competition in an industry is a more important determinant of the economic efficiency of an enterprise than the nature of its ownership *per se*. Improvements in economic performance flowing from the transfer of activities from the public to the private sector, together with the prospect of passing on the benefits to consumers, are more likely to materialize if accompanied by increased market competition.

100. Several other models are on trial. In various countries vigorous efforts are being pursued to remedy the lack of enterprise and inefficiency in particular parts of the public enterprise sector in ways other than

divestiture. These models seek to retain some at least of the distributional and other social objectives attached to that sector. However, the principal goal is to achieve a reformed and effective public sector in the expectation that this will, among other things, encourage the long-term development of indigenous private enterprise and facilitate corrective or offsetting action when markets fail to provide signals relevant to the development process. Some of these models involve an increase in the role of competition through liberalizing entry into activities previously restricted to public enterprises. Other options include joint ventures, and arrangements entrusting the private sector with the provision of a good or service, with public authorities retaining ultimate responsibility. The contracting out or franchising of public services and the leasing of public assets to the private sector are illustrations of this type of option.

101. In the same context, modes of planning have been under review in several countries. There is evidence that indicative planning as an instrument for strategic decision-making is not incompatible with an expanded role for the private sector. 3/ By permitting the participation of a wide range of economic and social factors it can facilitate a more effective integration of the social and other dimensions into economic policies and help establish priorities commanding wide public support.

102. At all events, relationships between the public intervention and the private sector are generally symbiotic. There is no clear-cut dichotomy between State and market, the two modes of social organization being interdependent and potentially complementary. And in most societies, including those in the developed world, the appropriate boundaries and interactions of these two modes are objects of continuing political debate.

103. At the international level too, the response of private enterprise to market incentives clearly will not suffice by itself to realize agreed objectives of sustainable world economic growth and development. Indeed, left to themselves market forces have contributed to uneven development in the world economy, with some countries growing rapidly while the majority have grown slowly or not at all. The international community has recently reaffirmed as a major goal the promotion of development in developing countries and the narrowing of the huge intercountry differentials in living standards that now prevail. Market forces do have an important role to play in the process, provided that every effort is made to harness them to this goal. Nevertheless, international intervention in the economic sphere involving deliberate policies and action on many different levels by governments as well as by intergovernmental organizations is indispensable if the obstacles to a healthy, secure and equitable world economy are to be overcome. The ramifications of this principle are discussed in the various relevant sections of the present report.

Chapter II

THE CHANGING ECONOMIC POLICY FRAMEWORK

A. Shifting perceptions

104. As already indicated, significant shifts have also been underway in approaches to economic and social organization, and in perceptions of development policy. The search for more balanced approaches has been given impetus by work within the developing world itself. 4/ Increased emphasis is now placed on development as a people-centred and equitable process in which the ultimate goal of economic policies must be to better the human condition, and to enhance the contribution of all people to the process; a primary objective should be to respond to the needs, and maximize the potential, of all members of society. A convergence of views has also emerged on the importance, for development, of political arrangements based on consent and, on the stimulus that the observance of human rights can give to creativity, innovation and initiative.

105. There is fuller understanding too of many of the ingredients necessary to loosen the constraints on growth and development. Countries widely recognize that the reactivation of development can only proceed within supportive frameworks of broad economic policy, both national and international. They also acknowledge that, in the absence of a facilitating international economic environment and deliberate national policies, development efforts will remain severely handicapped. Judgements differ, however, with respect to the relative weights of the external environment and of domestic policies and structural factors in the development process.

106. Domestic economic management is not, of course, amenable to the universal application of a single model. Yet, it is generally recognized that there is no substitute for sustained national policies directed at liberating and mobilizing all the latent energies and impulses for development within developing countries, at promoting efficiency in the allocation and use of resources, and at taking advantage of the opportunities for trade, investment and technological progress provided by the changing global economic environment. At the same time, governments have the responsibility and the collective power - with each contributing in accordance with its capacities and weight in the world economy - to influence the external environment. Only thus can they create conditions which would make the efforts of policy-makers and of economic agents in the developing world more productive. This reality of interdependence has gained some recognition in the context of relationships among the major industrialized countries, but the principle has global applicability.

107. Developing countries need to persist with or step up their efforts, in accordance with their national plans and priorities, to modernize their economies, keep control over inflationary tendencies, promote domestic savings, foster entrepreneurship, achieve favourable conditions for domestic and foreign investment and increase their international competitiveness. But these efforts will not gather momentum if the global economy lacks dynamism and stability and is beset with uncertainties. Likewise, development will be

retarded if existing constrictions such as external indebtedness, inadequate development finance, high trade barriers, and depressed commodity prices and terms of trade stay in place.

108. The industrial countries have acknowledged the importance of appropriate national macroeconomic and structural policies aimed at promoting non-inflationary growth and structural adjustment and at helping to avoid undesired exchange rate fluctuations and financial market disturbances. But they also have a special responsibility to narrow their imbalances in a manner that can benefit other countries, to intensify their efforts to invigorate world economic growth and to bring about a stable and predictable international economic environment for development. Furthermore, the coordination of their macroeconomic policies should take full account of the interests and concerns of the developing countries.

109. The broad responsibilities of developed and developing countries sketched above converge on the same objective of improved macroeconomic management, more effective structural adjustment and accelerated development, and are mutually reinforcing. They would need, however, to be complemented by stronger efforts to adapt and improve the systems, structures and arrangements which underpin international economic relations, so as to make them more conducive to development.

110. Shifting perceptions are also evident regarding the increased diversity of economic and social trends in developing countries, which is discussed in Part One, section E. This diversity has been used as evidence that both the concept of the developing world and analyses relating to these countries as a group have been rendered meaningless. However, the original justification for the concept lay, not in the uniformity of their economic situations, but in a common perception of their defendence and lack of autonomy in economic policy-making, in contrast to the developed countries, as well as in their common political interests and positions. Even so, for purposes of policy analysis and prescriptions, distinctions among different types of economies and development experiences have become increasingly unavoidable.

111. Differentiating developing countries by geographical region for all purposes is not by itself helpful, as it leads to highly generalized conclusions that obscure significant intraregional differences. A sounder option - analytically and politically - would be to adopt substantively disaggregated approaches to policy analyses undertaken for purposes of the development dialogue in multialteral forums. This practice has in fact been followed for several years in regard to the experience of debtor developing countries and it may, of course, in some cases coincide with regional differentiation.

112. Extending the same approach to other issue areas would imply a sharper focus on types of experience or performance such as technological capacity, export competitiveness, and the structure of the external sector, including, for instance, the degree of dependence on earnings from commodities, manufactures, services or labour remittances. The focus would accordingly shift away from analyses and policy presumptions geared to subgroups of countries defined by geographical location; likewise, categorizations of

developing countries that remain fixed for all purposes would lose their earlier salience in multilateral policy discussions, other than the already accepted category of "least developed countries".

113. Provided the resulting policy prescriptions are seen by developing countries as corresponding to their common interests as a whole and, no less important, are compatible and mutually reinforcing, such an approach would enhance the effectiveness of international action in favour of the developing world. It would have the clear merit of taking due account of the diversity of the situations and experiences of developing countries while recognizing the great divide that still separates these countries as a group from the developed world in terms of well-being and economic and technological capacities.

114. The diversity of economic performance among developing countries has also been invoked as justification for differentiating among them for the purpose of favourable treatment, particularly as regards GSP benefits; a number of preference-giving countries have withdrawn or reduced product coverage for beneficiaries which they deem to have attained competitiveness in certain product lines. In some cases such graduation measures have run counter to the principle of non-reciprocity. In other cases, they have been based on criteria that are either disparate from scheme to scheme or only tenuously related to trade performance. If product-country exclusions are unavoidable, then they should be based on objective, transparent and multilaterally agreed norms for assessing, prior to the exclusion of a beneficiary, the extent to which it has attained sustained competitiveness in a particular product.

B. Priority dimensions of the development process

115. Common perceptions have emerged on a number of priority aspects of development. One is the growing recognition that while an acceleration of economic growth is a condition for expanding the resource base of the developing countries and for economic, technological and social transformation, economic growth does not by itself ensure the equitable distribution of its benefits or the protection and improvement of the physical environment. If poverty persists or increases, and the human condition is neglected, political and social strains will become more intense. Similarly if environmental degradation increases, the natural resource case and the welfare of populations will be harmed and progress in development will become unsustainable.

116. Increasing emphasis is accordingly being given to the eradication of poverty and hence to patterns of development in which economic progress is distributed as widely as possible. Prominent in this approach is the generation of employment and incomes through productive occupation in sectors - as well as through the use of technologies - which would maximize the impact on poverty. For those sections of the population, particularly the poorest and most vulnerable, which might still be bypassed by this process, specifically targeted programmes, including key social services and facilities, are seen as necessary. The particular vulnerability of women and children calls for special focus on their needs in such areas as maternal and child health care, and nutrition. This convergence of views has important implications for the content of structural adjustment efforts in developing countries.

117. Strong consensus also prevails that priority should be given to the development of human capacities and the strengthening of the human capital of developing countries. Human resource development has the closest of interactions with the process of economic and technological transformation. It covers a wide range of activities that release the creative potential of individuals, enhance their knowledge and skills, and shape the style of development. A major objective in this regard must be to give full effect to the potential role of women in economic activity and to enable them to share equitably in the benefits.

118. Education and health are key aspects calling for special attention. The eradication of illiteracy, and a sound foundation of primary and secondary school education relevant to the country's needs for economic, social and political progress are basic requirements. The increasing role of knowledge in determining economic progress should also give fresh urgency to efforts to upgrade scientific, technological entrepreneurial and managerial capacities. This will require greater priority for higher education and for the development of the institutional base for the acquisition and improvement of skills.

119. Where health is concerned, primary health care and the prevention of chronic diseases demand sustained attention, as do such broad development objectives as sanitation, safe drinking water and nutrition. Several targets for the 1990s, including a number addressing the situation of women and children, have already been agreed upon by the international community. Their fulfilment will require vigorous efforts as well as appropriate adaptations to current structural adjustment programmes. As in the field of education, institution building and the training of skilled health workers need to be more generally accepted as essential ingredients in health policies.

C. Intensifying economic cooperation among developing countries

120. Stronger econonic cooperation among developing countries has long been accepted as an important component of efforts to promote economic growth, technological capabilities and accelerated development in the developing world. It could enable them to exploit more effectively the latent complementarities in their economies, gain access to additional resources and knowledge, and enhance the negotiating weight necessary to advance their common interests. Trading opportunities would expand and this would promote a fuller mobilization of their resources, which in turn would be a major stimulus to economic growth worldwide.

1. Recent developments

121. The optimism of the 1970s about the potential of ECDC was not borne out by the record of the 1980s. Integration groupings in all regions were confronted with difficult circumstances. Their institutional frameworks and cooperation mechanisms proved inadequate to meet the crisis which member countries experienced in their external sectors. The intra-trade of developing countries collapsed and payments, clearing and credit arrangements functioned at a low ebb. The demands of structural adjustment shifted the focus of countries to short-term policy reforms at the expense of long-term integration objectives.

122. Even so, interest in a political support for ECDC remained undiminished in recent years, integration processes at the regional and subregional level have received fresh impetus. Virtually every subregional and regional grouping has taken initiatives to improve its instruments of cooperation and to adapt them to the new realities. Groupings have intensified their search for international financial support for economic cooperation programmes and projects. There is stronger recognition of the link that should exist between national development policies and long-term integration objectives.

123. South-South trade and economic relations nevertheless remain the weakest link in the network of international economic cooperation. Developing countries increasingly appreciate that the lessons of the experience of the 1980s need to be set in the context of changing approaches to the organization of economic activity at both the national and international levels. The new approaches include the market-oriented reforms being pursued in most countries, such as deregulation of the economy, liberalization of trade and investment regimes and reducing the role of government in the ownership and management of enterprises. Fresh thinking is being brought to bear on the contribution that regional cooperation can make to improved economic performance in developing countries.

124. Greater emphasis is now being given to promoting a degree of harmonization among national structural adjustment policies and regional and subregional integration policies. Policies involving the curtailment of demand and investment in one member country can have adverse consequences for the others, and divergent exchange rate policies hamper trade as well as clearing and payments arrangements. Some groupings such as the Andean Group, the Central American Common Market, the Economic Community of West African States, and the Mano River Union are actively pursuing new ways of enhancing cooperation among member countries in this regard. The options under consideration include the design and implementation of trade, monetary and industrial policies. The European Community, through the latest Lomé Convention, has undertaken to provide support for regional approaches by African, Caribbean and Pacific countries to structural adjustment. Various organizations of the United Nations system, including most recently the international financial institutions, have expressed support for regional integration in the context of medium- and long-term approaches to structural adjustment.

2. Subregional and regional integration

125. One lesson of the 1980s is that regional economic integration is best approached as a long-term process, the pace of which depends, among other factors, on the instruments of integration, socio-economic conditions in member countries and changes in the external economic environment. In this context, intraregional specialization needs to be conceived not only in terms of exploiting complementarities among the countries concerned, but also as a means of improving the overall efficiency and competitiveness of their productive sectors so as to expand participation in regional and world markets. The limited size of regional and subregional markets underlines the importance of outward-oriented regional cooperation policies in support of development objectives.

126. The need has also become evident for a stronger focus on the mobilization of resources, both domestic and foreign, for investment, including investment to support cross-border infrastructural development and networks of industries serving both regional and global markets. Improving the investment climate from a regional perspective, particularly as regards foreign direct investment, could improve the prospects for expanding the supply of goods and services to those markets. Progress in harmonizing legislation and policies for investment, technology transfers, investment promotion could well prove to be a key to increased production and trade expansion within regions. Systematic exchanges of experience among member countries would facilitate such harmonization.

127. The experience of the 1980s has brought out other lessons for the expansion of intraregional trade, which remains a central objective of most regional groupings. Among the features essential for an effective regional trade liberalization programme are the implementation of standstill and roll-back agreements on trade barriers; the reduction of customs duties and non-tariff barriers; simpler fiscal compensation mechanisms; the inclusion of products with trade creating potential and a limitation on the scope of national exclusion lists; and less stringent rules of origin.

128. Preferential schemes, on which several groupings have relied for promoting growth in intra-trade, would have to be complemented by a range of other measures involving cooperation in the areas, for instance, of production and transport. Cooperation in industry, agriculture, energy and food production can be pursued through joint and other ventures and would promote the development and diversification of the production bases of numbers of regional integration groupings. It would also create opportunities for further trade and investment, in support of medium- and long-term market integration processes. These linkages however depend, inter alia, on the existence of adequate communications, transportation, marketing and distribution networks.

129. In the context of the broadly similar policies being carried forward by members of those groupings, encouraging direct cooperation among economic operators holds out the promise of revitalizing such trade. With this in mind, linkages should be fostered among industrialists, enterprises and traders, as well as between Chambers of Commerce and Industry across national boundaries. The evolution of integration groupings would also benefit from stronger interactions between member Governments and the private sector, particularly as regards investment promotion and joint ventures.

130. Even where market access is assured, trade cannot take root without conducive financial and monetary structures. In particular, trade financing on competitive and affordable terms is essential for trade expansion. Adequate longer-term credit facilities to meet this need are lacking in many developing countries and foreign banks often do not have established customer relationships on both sides of the trade relationship among these countries. Priority must therefore be given to expanding existing trade financing schemes and, where appropriate, establishing new facilities for that purpose. Developing inter-country banking networks would also help mobilize market funds and improve credit access.

131. In addition to trade financing, monetary arrangements for settlement, for clearing multilateral claims and for securing convertibility as well as realistic cross-currency rates can be crucial to intra-developing country trade. The strengthening of multilateral clearing and payments arrangements requires among other things the establishment of adequate credit facilities; the channelling of a substantial proportion of intraregional trade through clearing arrangements; a wider coverage of goods and services allowed into the clearing system; and measures to eliminate chronic intraregional indebtedness through supportive policies to develop the productive capacities of debtor countries.

132. Regular dialogues of the kind which the member countries of SADCC and ASEAN have established with interested developed countries on issues of mutual concern are providing their value. They can be increasingly useful as a mechanism for mobilizing policy support and financial assistance for integration and cooperation processes. They also provide a channel for external assistance for cross-border infrastructural projects and technical assistance for human resource development.

133. Finally, regional integration groupings need to address the problem of uneven distribution of benefits and costs among member countries. Since the benefits of economic integration tend, in the short to medium term, to gravitate towards the more advanced member countries, arrangements to provide a measure of compensation to other member countries would have to be considered. The possibilities include compensatory mechanisms (which are readily applicable) against loss of tariff revenue or production, and preferential industrial measures to develop the productive capacity of the affected countries.

3. Cooperation at the interregional level

134. In addition to strengthened regional and subregional integration efforts, arrangements to intensify the mutual cooperation of developing countries at the interregional level are indispensable in the wider ECDC strategy. The conclusions and lessons of experience discussed above as regards subregional and regional integration apply, mutatis mutandis, to interregional cooperation. In addition, it should be noted that as differences in factor endowments tend to be greater between regions than they are within them, even larger complementarities and trade potentials exist across regions. New complementarities are also emerging within the developing world as a whole as structures of production grow more diversified and as developing economies produce an ever wider array of manufactures from fairly simple labour-intensive products to high-technology items.

135. Appropriate mechanisms will have to be put in place if developing countries are to take full advantage of these opportunities. The Global System of Trade Preferences among Developing Countries (GSTP), which provides a basis for expanding interregional trade through the exchange of tariff, para-tariff and non-tariff concessions, as well as through direct trade measures, needs to be further developed. An improved GSTP, with wider particulation by developing countries, broader product coverage and deeper preferences, would create a large and dynamic preferential market which would also help enhance overall competitiveness. It would contribute to the overall

process of trade liberalization and the development of a more open trading system. By helping to expand and diversify world trade it would have positive effects on the world economy.

136. As within regional groupings, finance for trade on suitable conditions is vital for interregional cooperation. As already noted, exports of manufactures and capital goods require specialized longer-term credit which is not available in sufficient amounts or on affordable terms except in a few developing countries. The scale of the resources necessary to meet the needs of trade financing for exports from developing countries in the 1990s makes cooperative action essential. The proposal for a multilateral trade financing facility with the participation of development banks and private banking and financial institutions involved in the trade sector merits serious consideration.

137. Fostering cooperation at the level of enterprises offers another potentially fruitful possibility for expanding cooperation among developing countries. Deliberate efforts must also be made to engage enterprises in the design and implementation of interregional preferential trade liberalization schemes. There is considerable scope too for the involvement of private and public enterprises in the evolution of interregional arrangements for cross-border trade and investment, including joint ventures, and in the development of managerial and technical capacities. The Global Information Network among Enterprises and Business Organizations of Developing Countries which has been under consideration would greatly assist these processes.

D. The effective management of interdependence

138. The efforts of developing countries to improve their domestic economic policy framework will not have the desired outcome without a supportive international economic environment. Strengthening international action and multilateral cooperation for a healthy, secure and equitable world economy is thus the major development challenge for the 1990s. This entails among other things achieving the effective management of interdependence as already noted it must encompass stronger cooperation among countries to improve the structures, systems and arrangements underpinning international economic relations, particularly in the interrelated areas of trade, money and finance, to make them more supportive of development.

139. The experience of the 1980s has shown that the tightening and increased diversity of the linkages sketched in the preceding sections do not result spontaneously in outcomes that maximize the benefits of all, particularly where major countries pursue disconnected policies and independent courses of action. The successful management of interdependence accordingly requires that the national policies of countries having great weight in the world economy should be effectively coordinated. Such coordination is needed to avoid inconsistencies among these policies and to ensure that they accord with and advance global as well as national objectives while taking fully into account the interests of other countries, particularly the developing countries. Enhancing the effectiveness of multilateral surveillance now commands wide support. But its scope should extend beyond disequilibria affecting the major developed countries to encompass policies affecting trade capital flows, external adjustment and the effective functioning of the international monetary system.

140. A strengthened system of international policy coordination and multilateral surveillance should include targets for demand growth and current account imbalances. The burden of adjusting policy when outcomes differ from these targets should be shared between surplus and deficit countries in such a way as to avoid a bias towards deflation and high interest rates. This consideration is especially important, as developing countries are particularly open not only to the direct demand effects of the overall stance of macro-economic policies in the major OECD countries, but also the effects on international interest rates resulting from the mix of fiscal and monetary policies pursued by these countries.

141. This endeavour would also require the adaptation and strengthening of the institutional context in which it is to be carried forward. Among the factors calling for particular attention are the capacity to monitor the complex web of national and international economic forces at play and the exercise of influence commensurate with the responsibilities involved. Also essential are transparent decision-making procedures in which all countries, particularly developing countries, play an appropriate role, and supportive institutional arrangements at the regional and interregional levels.

142. The broader question of the management of interdependence is closely related to the functioning of the systems and structures that have provided support for international economic relations so far. During the past two decades, the institutions and processes concerned have undergone several adaptations in response to circumstances. But these have not been sufficient to cope with the rapidly changing realities of the world economy over the past several years or with the shifting interrelationships among issues in the key areas of economic policy. The functioning of the international monetary system has faced serious problems with regard for instance to exchange rate management and the provision of adequate world liquidity. The resources of the international financial institutions have not been available in amounts adequate to the demands of structural adjustment with growth in developing countries. The accepted rules and principles of international trade have been eroded.

143. The necessary processes of change in the international economic framework must be urgently pursued. The common goal should be to provide firmer support in particular for the development process, but also a more conducive setting for the vigorous policy reforms being carried forward in most developing and other countries as well as an improved climate for the efforts of developed countries to achieve better macro-economic management and structural adjustment. The desirable thrust of the changes required in the different areas is explored at greater length in the relevant sections of this report.

144. Where the international trading system is concerned, the objective must be to make it more open, secure and non-discriminatory trade relations and to ensure that new rules dealing with services, technology and investment issues adequately take into account the particular interests of developing countries. The Uruguay Round should, in addition, preclude recourse to unilateral coercive approaches which threaten the integrity of the system. A positive and balanced outcome must remain the primary criterion for assessing the results of the negotiations. In the area of commodities, greater efforts should be undertaken to achieve lasting solutions to the short-, medium- and

long-term problems with which commodity-dependent countries continue to contend, notably through stronger international cooperation between producers and consumers. The need is urgent for a more coherent and effective international commodity policy which would among other things promote a better functioning of commodity markets, stable and more predictable conditions in commodity trade, and a better contribution by the commodity sector to the development process.

145. The necessity for far-reaching adaptation and improvements in the existing international monetary and financial systems has been the subject of discussion for several years. A decisive effort should be undertaken by the international community as a whole to arrive at an effective and durable solution of the debt crisis. Steps should be taken to secure an adequate level of long-term financial flows to developing countries. In this regard, the role of development finance institutions in intermediating private capital flows needs to be significantly enhanced. As regards the international monetary system, efforts should be directed towards a number of objectives. These include securing for the international community greater influence over the creation of international liquidity so as to ensure a better response to global requirements, and the needs of developing countries; major improvements in the existing facilities for helping developing countries to cope with their immediate and longer-term balance-of-payments difficulties; the promotion of greater stability and predictability of exchange rates and interest rates, the latter at levels consistent with high rates of growth and investment in the world economy and especially in the developing countries.

146. The question of the involvement of the developing countries in intergovernmental decision-making concerning the evolution and functioning of the international monetary and financial systems remains a matter of concern. Effective participation by developing countries in such decision-making is especially important because, under current arrangements, they lack influence on international policy in several areas crucial to the welfare of their peoples - a condition which they share in some respects with smaller industrial countries.

147. The need persists for the major industrial countries to engage in a meaningful and continuing dialogue with developing countries in a multilateral framework on salient international monetary and financial issues, so that the interests of the latter countries can be adequately taken into account. The importance of securing the cooperation of these countries as they become a more important factor in the world economy, and the increased international concern with democratic governance, underline this need.

148. The international community must also evolve policies which would allow the new more favourable approach apparent in developing countries towards direct foreign investment actually to result in increased international investment, and which would strengthen the developmental impact of such investment. Agreement on codes of conduct for transnational corporations and for the transfer of technology, which have engaged international attention for many years, as well as the reinforcement of measures to eliminate restrictive business practices, should be more vigorously pursued so as, among other things, to invigorate competition in several currently imperfect markets, establish adequate safeguards for host countries, and provide stronger support for the development process.

149. Future world economic stability and growth will depend on higher levels of international economic cooperation for the management of interdependence. Over the past several years interdependence has often served to amplify and speed the transmission of negative impulses in the world economy. But if policies are formulated in a mutually reinforcing fashion to favour constructive adjustment and adaptation in the world economy, interdependence can become a more consistent vehicle of growth and development, cumulating benefits for all in a positive sum game.

Part Three

POLICY ISSUES IN THE INTERRELATED AREAS OF RESOURCES FOR DEVELOPMENT, INTERNATIONAL TRADE, TECHNOLOGY, SERVICES AND COMMODITIES

Chapter I

MOBILIZING RESOURCES FOR DEVELOPMENT

150. A large number of developing countries are now locked in a vicious circle of over-indebtedness, under-investment, increasing macroeconomic instability and inadequate external support, often accompanied by social and political conflict. Problems of domestic and external resource mobilization have become closely intertwined with the debt problem. Similarly macroeconomic and structural policies have become more closely connected through their link with public finance.

151. Breaking out of this vicious circle and moving on to the path of sustained growth and development presents a formidable challenge. Domestic reforms are indispensable. But governments will continue to face a policy overload unless they are accorded assistance that is timely and on a scale commensurate with their problems. Equally important, policy reform should be governed by long-term perspectives rather than the exigencies of managing financial crisis, and by practical rather than ideological considerations.

A. Domestic resource mobilization in developing countries

152. The acute external financial difficulties faced by developing countries in the 1980s have heightened the importance of mobilizing domestic resources and of allocating and utilizing them to maximum effect. Such efforts are needed not only to manage debt and the balance of payments but also to sustain development over the longer term.

153. There is relatively limited scope for increasing the level of savings in developing countries which have suffered a significant drop in living standards in recent years. Although in a number of developing countries tighter fiscal discipline is desirable, an improved overall savings performance will have to be sought largely as a consequence, rather than as a precondition, of renewed growth. There is, however, considerable room for improving the way savings are allocated and utilized through policy reforms regarding the financial sector and the public sector. Progress in these areas will contribute significantly to growth (and hence allow the overall propensity to save to be raised), provided that it is not offset by increased debt-service payments or reduced inflows of external finance. Indeed, debt relief and/or increased capital inflows could serve to increase domestic savings by lessening the foreign exchange constraint which, in many developing countries, limits the level of incomes to well below the level warranted by the productive capacity of the economy.

1. Financial policies

154. While interest rate policies have a weak impact on the level of savings they have a pronounced effect on the way savings are allocated and used. They exert a strong influence on the behaviour of savers and financial intermediaries, and on the forms in which savings are held and transferred, and hence on the terms and availability of finance to various sectors and economic activities.

155. One of the most important impediments to resource mobilization in a large number of developing countries is macroeconomic instability and unpredictability. High and volatile inflation, and unexpected swings in wages, exchange and interest rates create a high degree of uncertainty in the cost of, and return on, investment in both physical and financial assets. This shortens the planning horizons of savers and investors, and encourages hedging and speculation rather than long-term investment in productive capacity. As long as inflation remains high and uncontrolled, attempts to change the key relative prices in order to encourage savings and investment can be unproductive. Indeed, under such conditions attempts to adjust through currency devaluations and interest rate increases often accentuate instability. Attaining macroeconomic stability requires increased monetary control and greater financial discipline. However, monetary policy should not be overburdened: a judicious combination of fiscal, monetary and prices and income policies is usually needed.

156. Equally harmful are uncertainties in the rules of the game, and lack of continuity and a long-term perspective in policy-making. Abrupt and unpredictable changes in policies in areas such as trade, finance, public sector prices, subsidies and taxes tend to complicate calculations and decision-making, encourage rent-seeking, and stimulate behaviour aimed at capturing windfalls from unpredicted changes rather than productive investment. Without social and political consensus, as well as a secure, confident, skilled and depoliticized bureaucracy, it is often difficult to ensure continuity and confidence in policy-making.

157. Macroeconomic mismanagement and policy discontinuity are by no means the only or even the main sources of instability. Developing countries are extremely susceptible to changes in their external economic environment, which, as already noted, is itself unstable. External shocks such as commodity-price or interest-rate swings are often highly disruptive, and the difficulty of adjusting to them without adequate external finance is in itself an important source of discontinuity in policy-making.

158. While interest rate policies are important in the context of domestic resource mobilization, what constitutes an appropriate interest rate policy in any particular situation is not a simple matter. A higher interest rate raises not only the rate of return for creditors but also the cost of finance for debtors. It adds to the capacity of rentiers to save, but subtracts from the capacity of entrepreneurs to invest. The balance of these effects needs to be fully reflected in interest rate policy. In practice this has not always been done. Before the 1980s, policy makers in many developing countries tended to concentrate on the cost aspect of interest rates even when inflation was high, giving rise to excessively negative real interest rates.

By contrast, in the 1980s undue emphasis has been placed on the return to creditors, leading to excessively high real interest rates; these have often reached double digit levels.

159. In designing interest rate policies, due attention should also be paid to the degree of corporate indebtedness, the contribution of corporate savings to private investment, the state of the fiscal balance and the size of public debt. Since changes in interest rates affect the distribution of incomes between debtors and creditors, they affect the aggregate level of savings when debtors and creditors have different savings rates. Normally, corporations and the public sector are net borrowers and debtors, and the household sector is a net lender and creditor. In many countries the saving rates of the corporations is higher than that of the household sector, and undistributed corporate savings constitute an important source of business investment. Thus, high interest rates may not only discourage corporate investment, but also reduce aggregate private savings by transferring incomes from high to low savers. Similarly, if the interest-bearing domestic debt of the public sector is large, high interest rates can cause large fiscal deficits.

160. As far as the allocation and utilization of savings are concerned, the impact of interest rate policies depends largely on the efficiency of financial institutions. In many developing countries, these suffer from serious structural deficiencies. In a large number of developing countries, an important portion of bank assets is non-performing. The majority of both private and public banks are technically insolvent and operate with very large intermediation margins between deposit and credit rates. Moreover, the financial sector often does not conform to the competitive paradigm, and ownership of banks is highly concentrated. Prudential regulations on banks are weak, and governments are too ready to engage in financial rescue operations.

161. In view of these structural deficiencies in financial institutions in developing countries, financial liberalization will work only if accompanied by appropriate institutional reform and vigorous supervisory and prudential arrangements. The recent experience of financial liberalization in developing countries also demonstrates that it has worked successfully only where a gradual and cautious approach was followed, and where liberalization was introduced after macroeconomic stability and institutional development had been attained. Where increased cost efficiency cannot be attained by deregulation, a ceiling on lending rates may be needed.

162. The development of capital markets can help to solve some of the structural problems and enhance the efficiency of financial intermediaries by introducing competition and reducing the vulnerability of firms to variations in the cost and availability of bank credits. However, capital market development is made difficult by a number of structural factors. In developing countries, firms are often owned by families which do not wish to dilute their control. Moreover, owners are often unwilling to disclose the information and accept the supervision entailed by going public. Increasing the cost of borrowing, therefore, does not always encourage firms to go public. Moreover, firms that are large enough to do so often choose not to

because they can continue to benefit from preferential treatment from banks. Tax and other incentives, and restrictions on corporate borrowing, may be needed to spur equity issues.

163. The problem of inefficiency and instability of capital markets can be especially serious in developing countries since the general macroeconomic environment tends to be more volatile in these countries. Indeed, in some of the newly-emerging capital markets prices have been subject to large swings. Activity has concentrated in secondary transactions, and new issues to raise investment finance have been rather small. Moreover, in order to forestall irregularities such as insider trading and fraud - and because the administrative capacity to undertake effective supervision is weak - the provision of an appropriate institutional and regulatory framework is the necessary complement of any system of tax and other incentives aimed at developing capital markets.

164. Thus, while it is necessary to strengthen the role and structure of markets, it is no less important to strike the right balance between market forces and intervention in the allocation of resources. Industrialization and development call for the assignment of priorities to different sectors and activities, and provision to them of support, incentives and protection, often on a selective basis. In the financial sphere, this implies some differentiation of cost and the availability of finance (in line with the practice in many industrialized countries). Almost all developing countries have used directed credit allocations, and differential financial taxes and subsidies for certain types of credits, such as for export industries and agriculture. "Successful" and "unsuccessful" developing countries have differed not so much in the extent to which governments have sought to "pick winners", but in the degree to which they have been able to ensure that support and protection provided by them has been used for the purpose intended, and has not served as a pure "rent".

2. Public sector reform

165. Policies regarding the public sector, comprising the government and State economic enterprises, have a major role to play in resource mobilization. In many countries there is considerable scope for raising public-sector savings. Moreover, public sector investment accounts for a substantial portion of total domestic capital formation, and improvements in its efficiency would make a significant contribution to overall economic growth.

166. There is wide acceptance that an economically efficient and institutionally strengthened public sector is essential for restoring growth in developing countries. In many developing countries, economic revival requires public sector investment to rise. This, however, needs to be achieved in the context of fiscal reform. The principal objective of such reform should be greater efficiency in policy-making which requires: defining economic and social objectives explicitly, assigning appropriate policy instruments to these objectives and monitoring the performance vis-à-vis policy inputs.

167. There is substantial scope for improvement in developing countries on all these fronts. Policy actions do not always reflect explicit, calculated, and deliberate choices based on an awareness of alternative costs and opportunities. Nor is it always clear what objectives certain policy instruments (such as subsidies and tax breaks) are serving. It is especially important to monitor continuously the performance of policy instruments. For instance, periodic assessments should be made of the various fiscal incentives given to the private sector (including subsidies for exports, investment and employment) to ensure that they are matched by improved performance. Similarly, evaluations should be made of the effects of various categories of government spending on basic needs, life expectancy, infant mortality, literacy and so on.

168. Reallocating existing budgetary resources on the basis of such principles could provide important gains in efficiency, for instance by arresting the deterioration in physical and human infrastructure, giving greater weight to areas that facilitate export expansion such as communication and transport, and increasing spending on poverty-alleviation. As already indicated in Part One, Chapter I.A, one area where cuts in public expenditure appear to be both possible and highly desirable is in military spending; this would also bring the additional benefit of releasing scarce foreign-exchange resources. Due attention should also be paid to the need for rationalizing spending on public administration without lowering quality.

169. However, they key to successful fiscal reform is greater equity and efficiency in taxation. In developing countries the tax system often has serious defects in its revenue, equity and incentive aspects. In the face of the crisis of the 1980s, many governments have been unable to place any significant part of the burden of adjustment on owners of wealth or the highly skilled labour force without provoking capital flight and brain drain. Consequently, taxes on financial incomes, profits and capital gains have remained remarkably low. In many countries the government has paid out more in subsidies to private corporations than it has received from them in taxes.

170. The tax system has been extensively used for the pursuit of industrialization strategies. But, many of the special tax rates and exemptions have remained long after they ceased to be useful, at the cost of reduced tax revenues, distortions in incentives, and over-complexity in tax administration. In the 1980s, attempts to increase budget revenues through ad hoc measures introduced further distortions, and worsened the distribution of wealth and income; they also encouraged the underground economy and the emergence of an ethic of tax evasion.

171. Fiscal reform should aim at rationalizing and simplifying the taxation system, ensuring equitable treatment of different categories of income, protecting government revenues from erosion by inflation, and strengthening tax administration. The political difficulties and obstacles are formidable. To surmount them requires a social consensus on both the need for such reforms and the distribution of the burden among various classes and groups, as well as on good governance and constructive political dialogue.

172. In recent years, there has been growing recognition of the need to reform State economic enterprises, with measures ranging from liquidation to rehabilitation. As discussed in Part Two, Chapter I.D, privatization could play an important role. It should, however, be based on a careful assessment of the options, bearing in mind that privatization does not necessarily raise the level of savings and investment. Nor will it necessarily improve economic performance if management proves unable to maintain financial discipline, or if the privatized firm enjoys a high degree of monopoly power. Moreover, where competition is imperfect, as is normally the case in most developing countries, privatization needs to be accompanied by an effective regulatory framework to foster competition.

B. Debt and external resources

173. The primary source of development finance has been, and will remain, the savings efforts of developing countries. Even so, they will need increasing amounts of external financing to supplement their own efforts. Private financial flows to developing countries are not likely to revive on a major scale in the coming years. Meeting the external financial requirements of developing countries will, therefore, require more vigorous debt relief measures and stronger mobilization of official external resources. For most poorer developing countries, the aid effort, through both bilateral and multilateral programmes, will remain of central importance and policies determining the overall availability of concessional finance will be crucial. For the heavily indebted developing countries, a durable solution to the debt problem will be a prerequisite for increased access to financial flows. Increased attention will also have to be paid to the way in which international financial policy can facilitate the mobilization of domestic resources.

1. Towards a durable solution to the debt crisis

174. The debt crisis is far from being resolved. A few middle-income debtor countries have achieved some progress in stabilizing their economies and in attracting back flight capital, but most heavily indebted countries are still facing enormous difficulties.

175. The international debt strategy has evolved considerably since UNCTAD VII. It is now recognized that solutions to the debt problem should include debt and debt-service reduction as a central element. However, the scope of debt relief resulting from the Brady and Toronto initiatives has been rather limited. To provide a durable solution to the debt crisis, the international community should, therefore, consider bolder approaches.

176. In the area of debt owed to private banks, the agreements so far concluded under the Brady initiative have resulted in much less debt reduction than is required. The agreements for some countries are more akin to conventional reschedulings. For others, debt-reduction operations are counterbalanced by debt-increasing ones. Moreover, the agreements have made the remaining debt more difficult to restructure.

177. With a view to enlarging considerably the scale and pace of debt and debt-service reduction, the Brady initiative needs to be strengthened in several ways:

(a) The negotiation process between debtor countries and commercial banks should be anchored on authoritative estimates of the country's debt reduction and cash flow needs, rather than determined by the balance of negotiating strength. The multilateral financial institutions could play a useful role in this regard.

(b) National laws and regulations in creditor countries could be directed more effectively towards achieving adequate levels of debt and debt-service reduction. For example, regulations on tax reductions on loan-loss provisions and tax relief on losses could be harmonized in such a way as to enocurage banks to participate in debt-reduction packages.

(c) Any increase in the financial support for debt reduction provided by multilateral financial institutions and the regional development banks should be accompanied by measures to put additional funds at the disposal of these institutions. Otherwise, lending for new investment, which is essential to successful adjustment, could be adversely affected.

178. With regard to debt owed to official bilateral creditors, there has clearly been some progress in alleviating the debt burden of low-income countries. The Toronto agreement marked a significant step forward in that for the first time creditor governments recognized the need for relief with regard to non-concessional official debt. However, the degree of relief granted falls far short of what is warranted by the debt-servicing capacity of low-income countries. Proposals have been made recently by several creditor governments to bring about a much bigger reduction of debt and debt service for these countries (including a reduction of up to 100 per cent in the Netherlands scheme). These proposals deserve serious and urgent consideration. The "Trinidad and Tobago terms" proposed by the United Kingdom would represent a major advance, but for numerous low-income countries debt burdens would still remain too high. Moreover, debt relief should not be at the expense of fresh aid. The list of beneficiaries of the Toronto Terms has recently been widened to include IDA-only countries of Latin America and the Caribbean, but eligibility criteria need to be further reviewed. As a first step, all least developed countries and all IDA recipients should be allowed to benefit.

179. The burden of official debt on lower middle-income countries has recently received more attention by creditor countries. The new Paris Club policy for heavily indebted countries in this category involves longer maturities and grace periods. This represents a step in the right direction. However, many of these countries will need reduction of their official bilateral debt as well as of their debts to commercial banks. A major step forward has been taken in the case of Poland and Egypt, whose prospects will be significantly improved by the recent decisions to reduce their official bilateral debts by at least half. It is to be hoped that the many other low- and middle-income countries whose burden of bilateral official debt is excessively onerous, will

receive comparable treatment. In order to foster adjustment and growth, the international debt strategy must be governed by objective economic criteria and not by political preferences or narrow financial concerns.

180. The issue of multilateral debt has also become a matter of concern. Net financial transfers from multilateral institutions to some highly indebted developing countries have declined sharply, and a number of debtor countries are experiencing difficulties in meeting their obligations. Although measures have been taken by multilateral institutions to alleviate the servicing burden and to help clear the arrears, they are not sufficient. Further measures are needed to deal with the multilateral debt problem, while safeguarding the soundness of creditor institutions. "Support Groups" could be made more active in providing resources for the purpose of clearing arrears to multilateral financial institutions. Other existing mechanisms, such as interest rate subsidies or refinancing schemes funded by reflows or special trust funds, could also be strengthened and widened.

2. External financial resources for development

181. The debt crisis has produced far-reaching changes in developing finance in the 1980s, the impact of which will probably continue to be felt throughout the 1990s. In real terms, net external resource flows to developing countries in 1989 were about half the level of 1981. This decline was accompanied by an unprecedented reversal of net transfers to developing countries burdened by rising interest payments on their debt. The absolute level of official financial flows to developing countries has been virtually stagnant in real terms over the past decade.

182. Debt reschedulings and adjustment lending are now important components of financial flows, and a growing proportion of external assistance carries macroeconomic and structural policy conditions. Indeed, IMF and the World Bank together form the linchpin of the development finance system. The process of structural adjustment needs to be adequately funded, if the impact on growth and development is to be positive and sustainable. Moreover, there is need to review conditionality in order to ensure that it acts as an incentive for, and not a deterrent to, efficiency.

183. In addition, special efforts will be required in the 1990s to redress the backsliding that has occurred because of inadequate financial support in areas such as food security, poverty reduction, human resource development and infrastructure investment, and to finance environmental conservation.

184. The experience of the 1980s has clearly brought out the severe limitations of an approach which relies heavily on the private commercial banks to meet the bulk of the requirements of external development finance. In order to ensure greater stability, predictability and a more efficient use of available resources, it would be desirable to strengthen the already substantial role of official finance. In this regard, donor countries should make serious efforts to reach the ODA target of 0.7 per cent, and the international financial institutions should play a much larger part in meeting the requirements of development finance.

185. It is encouraging that at the Second United Nations Conference on the Least Developed Countries, donors have made commitments to increase resource flows to the least developed countries, so as, inter alia, to reach and exceed the target of 0.15 per cent. Donor countries have also agreed in principle to increase the capital base of the World Bank and of regional development banks, to increase IMF quotas, to provide resources for the ninth replenishment of IDA and to fund special actions or facilities in favour of low-income countries. However, the resources made available to multilateral and regional financial institutions will have to be assessed against the increasing demands and the new tasks facing these institutions. The number of countries eligible for IDA resources is growing, and IMF and IBRD will be paying increasing attention to Central and Eastern European countries. A substantial increase in the flow of development finance to developing countries through these institutions will require some innovative mechanisms to tap international capital markets.

186. Central and Eastern European countries have drastically reduced their financial assistance to developing countries, and may become very substantial recipients of finance from official sources. There are many uncertainties about the content and the pace of the reform process, and the extent to which external financial support will be forthcoming. The impact of flows to Eastern Europe on the volume and pattern of financial flows to developing countries will nevertheless need to be closely watched. As previously recalled, reassurances have been given by DAC members that their support to the reform processes in Central and Eastern European countries will not diminish their determination to give high priority to their development cooperation with the third world. No effort should be spared to prevent the diversion of flows, especially ODA, away from developing countries.

187. The time has also come to renew the search for more automatic sources of revenue for financing high-priority development activities. In view of the prospects for disarmament and reduced military expenditure that have been opened up by the ending of the Cold War, greater attention should be paid to the possibility of channelling the resources that may be thus released towards socially productive uses, including development finance. In this connection, the issue of structural adjustment for the transition to disarmament and the implications for world economic growth and development should be given increasing importance in the international development cooperation dialogue.

3. Promotion of non-debt-creating flows

188. Considerable efforts are being made by developing countries to improve the policy environment for foreign direct investment (FDI). FDI can play a significant role in revitalizing exports and there is growing recognition in many developing countries of the advantages of FDI in project finance, acquisition of technology and development of external markets. Governments of many developing countries are also seeking ways to exploit more effectively opportunities for new forms of investment, such as joint ventures, licensing and subcontracting, as well as portfolio investment and new forms of quasi-equity investment such as commodity bonds. Stronger and more stable regional common markets can also be helpful in attracting foreign direct investment.

189. Substantial inflows of equity and quasi-equity finance are being increasingly sought in developing countries both to redress the imbalance between debt-creating and non-debt-creating flows and to compensate in part for the sharp decline in commercial bank lending. But expectations that more liberal treatment would stimulate substantial amounts of new inflows have not been fulfilled. The debt crisis has continued to stifle FDI flows to developing countries by feeding the general perception of high risks, diminished profitability and poor prospects for growth. Meanwhile, investment opportunities within the developed countries have been expanding. Despite the use of debt-equity swaps, the volume of net FDI inflows in real terms to developing countries is still lower than it was before the crisis. The share of developing countries in total FDI has fallen from more than one quarter in the early 1980s to less than one fifth in the late 1980s. At the same time, and as already indicated, the interrelationship of FDI with trade, technology and services has become a crucial issue for the 1990s.

190. The efforts of developing countries will need to be complemented by adequate and timely action by FDI-exporting countries and the multilateral financial institutions. In addition to efforts already undertaken by them, industrial countries should put in place comprehensive frameworks for the benefit of developing countries encompassing trade, investment and debt reduction - the United States "Enterprise for the Americas" initiative is relevant in this context - backed by adequate financing. Such initiatives should also aim to give a greater role to regional institutions, especially the regional development banks. Governments should also act quickly to enhance considerably the role of the World Bank Group, in particular the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA), by agreeing to a substantial increase in the capital base of the IFC and by increasing MIGA's capacity to provide guarantees for investment projects. A stronger sponsorship role by the World Bank Group on behalf of a larger number of developing countries could send to investors an unmistakable signal of confidence in the future and fortunes of developing countries.

C. Environment and development finance

191. Overexploitation of natural resources and environmental degradation deprives future generations of a sound resource base. In developing countries, environmental degradation is closely linked with the persistence of poverty and restricted economic opportunities for the poorest. The solution to environmental degradation should thus be sought in broad-based development programmes based on an effective strategy for eliminating poverty and acquiring environmentally sound technologies. Such a strategy requires external financial support on a large scale.

192. Developed countries would themselves benefit from providing such support. Environmental conservation in developing countries will help to improve the global ecological system. It is widely accepted that the patterns of development and consumption in developed countries are responsible for the bulk of the damage to the global environment. Shifts in patterns of development and consumption in developed countries that would be consistent

with the protection of the environment and the additional financial needs of developing countries must be an important focus of international cooperation and multilateral action in this domain.

193. In recent years, progress has been made, and prospects for further advances appear promising. The recent agreement on funding for the Interim Multilateral Fund established under the Montreal Protocol on Substances that Deplete the Ozone Layer to assist developing countries' signatories of the Protocol is to be welcomed. Nevertheless, Governments must be prepared to establish the necessary mechanisms which would ensure the realization of the dual objectives of environmental protection and adequate transfer of resources to developing countries within a stable, predictable and equitable multilateral framework. Particular attention should be given to mechanisms that simultaneously make maximum use of market signals and generate additional financial flows. In this regard, consideration should be given to the imposition of taxes and user fees on environmentally damaging activities and products. Likewise, in approaching the issue of controlling carbon emissions worldwide, consideration should be given to the establishment of a global scheme of tradeable emission permits.

194. The tripartite arrangement set up by the World Bank, UNEP and UNDP to manage the Global Environment Facility (GEF) for the benefit of developing countries is an important step in the right direction. However, as the Heads of these institutions have pointed out, the utilization of these resources should not be at the expense of their regular development and national environmental activities. Additional funds for dealing with global environmental problems are essential.

Chapter II

IMPROVING THE INTERNATIONAL TRADE ENVIRONMENT

195. In the field of international trade, the struggle between the conflicting forces of open trade and protectionism has not yet been resolved. Since UNCTAD VII, the evolution of the international trading environment has been marked by contraditory developments. Efforts in the context of the Uruguay Round of multilateral trade negotiations towards a more open, viable and durable trading system were complemented by a variety of trade policy initiatives. These included unilateral trade liberalization measures by developing countries and a relaxation in discriminatory measures previously applied by developed countries against several Central and Eastern European countries.

196. In contrast, the international trading system continued to be threatened by growing protectionism and increased tendencies towards managed trade, and by frequent recourse to unilateral measures in conflict with the basic principles of the system. Particularly for weaker trading partners, the persistence of this situation created further uncertainties, discouraged new investment in the export sector and hampered the structural adjustment to which many developing countries are committed. The Uruguay Round process may itself have had a restraining influence on the proliferation of protectionist measures but these developments suggest some loss of faith in the multilateral system. The international community faces a clear choice: revitalizing and improving its rules or sliding into managed trade, tiered preferences, and inward-looking trade blocs.

A. Trade policy reform in developing countries

197. In recent years, a large number of developing countries have taken measures to open up their economies and to give exports a more prominent role in their development strategies. The trade policy reforms that accompanied these shifts varied in intensity. Broadly, they involved a combination of trade liberalization measures, currency devaluation, greater reliance on exchange rates as a balance-of-payments equilibrating mechanism, tighter fiscal disciplines and stronger export promotion measures. The response to these policy changes in terms of investment and growth has been uneven.

198. Several countries with well-diversified economic structures and relatively developed human and technological capacities were able to expand their trade sector, stimulate new investments and promote sustained economic growth. They were also relatively successful in maintaining price stability. But trade liberalization measures failed to stimulate new investments and economic growth significantly in countries lacking flexible and diversified economic structures. Moreover, in debt-distressed countries, because of the external debt-service burden, the ratio of imports to the gross domestic product failed to rise with the export-GDP ratio. Import compression and falling investment were common experiences in these countries.

199. Recent studies suggest a need for caution in asserting direct relationships between trade policy and trade performance in developing countries. During the 1980s, those countries which recorded the fastest rates of export growth followed policies of selective intervention, although some countries which intervened heavily to alter market-determined outcomes did not fare as well. Countries which supported industries that held out the promise of international competitiveness in the longer term performed significantly better in terms of both output and export growth than countries where policies of selective intervention did not have as clear an economic rationale. Most countries which introduced drastic, across-the-board, trade liberalization packages have not yet been able to raise their export growth rates. The prospects that they will do so in the near future depend among other factors both on their ability to maintain stable exchange rates remunerative to exporters and on their overcoming the macroeconomic disorder that is bedevilling many of their domestic management efforts.

200. These experiences point to a number of lessons. First, trade policy cannot be considered in isolation. Trade performance depends not only on the limited range of questions such as tariffs and quantitative restrictions, export taxes and subsidies - that are normally to be considered the core of trade policy. It also depends on long-term factors such as the country's economic infrastructure, including the skill of the labour force, as well as on related short-term influences such as investment policy and the rate of exchange. Overall macroeconomic stability is a prerequisite for sustained improvement in trade performance.

201. Secondly, this finding can itself create a policy dilemma because, in the short term, trade-offs may be required between the measures just mentioned. In particular, an undervalued real exchange rate is often a major determinant of trade performance, whereas usually a stable (or sometimes somewhat overvalued) exchange rate is considered necessary to counter inflation. While other arguments may favour an overvalued exchange rate, the trade dimension should be given due weight in decisions on exchange rate policy.

202. Thirdly, the impact of trade policy can benefit greatly from supportive investment policies, with emphasis as may be required on particular sectors or industries. As world trade is increasingly globalized and an even larger proportion of trade takes place within corporate networks, transnational corporations could be a significant link with world markets in the early phases of export diversification. They could provide not only an outlet for exports but also a source of inputs, particularly of technology and information. Governments wishing to draw upon these capabilities should give priority to the creation of a favourable investment climate for such corporations.

203. Furthermore, many of the requirements for a favourable investment climate are long term in nature. Indeed, one of the most important conditions for successful trade expansion is a sustained joint commitment by both Government and enterprises to the strategy that is adopted. In outward-oriented strategies, general trade measures need to be complemented by policies that favour exports in sectors where the country has a dynamic comparative advantage and hence long-term export potential.

B. Enhancing efficiency in international trade

204. Efficiency in the conduct of international trade transactions remains essential for the expansion of the trade of developing countries in particular and for their mobilization of external resources, including private investment. Improved infrastructures encompassing among other things transport, distribution, port and telecommunications would contribute to this objective, as would streamlined customs procedures and enhanced insurance and trade finance facilities. Inefficient trade practices, procedures and organizational arrangements have been giving rise to considerable misallocation of resources and have contributed to low economic performance, poor competitiveness and disappointing results from trade-oriented development strategies.

205. Many developing countries have sought to reduce the administrative and other impediments facing exporters by creating export processing and similar free trade zones. Such arrangements can facilitate not only the duty-free import of inputs but also result in other economies of scale in providing supportive services to exporters. The experience of countries in this regard underlines the broader point that the overall trade infrastructure, together with the availability of low-cost export finance, is crucial for successful export development.

206. Recent advances in information technologies offer opportunities for vastly improved trade efficiency. To this end, a concerted effort must be made to accelerate and consolidate the work under way in this domain, such as the use of the Electronic Data Interchange (EDI). In the area of trade-related information flows and networks, early multilateral initiatives could lead to rapid improvement in the efficiency of international trade transactions at relatively low cost. Efforts to evolve universally acceptable guidelines should, inter alia, give due priority to the development imperative. Otherwise developing countries would be further marginalized in the more profitable currents of international trade.

C. Protectionism, market access and structural adjustment in developed countries

207. Broad trends in trade policies affecting the market access of developing countries during the 1980s did not give cause for optimism. Protectionist measures in major market economies tended to concentrate in sectors where developing countries have a distinct comparative advantage and international competitiveness. Tariff levels in developed market-economy countries continued to be higher on products of export interest to developing countries than on other imports, and tariff escalation in step with the degree of processing remained a handicap. Tariff concessions under the GSP, which in any case suffered some erosion, redressed these problems only partially, since only about one fourth of the dutiable exports of developing countries enjoy preferential treatment; there is wide agreement that the system needs to be strengthened and its coverage extended.

208. The most serious impediment to market access, however, was the proliferation of non-tariff barriers, which currently affect almost 30 per cent of the exports of developing countries to the developed market economies. These barriers include a wide variety of measures often directed specifically against developing countries, including voluntary export restraints, surveillance measures, export subsidies and the use of anti-dumping laws for protectionist purposes. In sectors of particular export interest to developing countries, the proportion of affected trade ranged from one half to three quarters.

209. Yet other developments occurred in international trade policy which give cause for concern. These include: the tendency to establish linkages between the implementation of previously agreed commitments in the area of trade in goods and concessions in other areas, such as foreign direct investment, protection of intellectual property, and services; the unilateral withdrawal as already mentioned, of preferential measures previously accorded to developing countries for reasons often running counter to agreed commitments; the use of arguments of trade balance to press for bilateral reciprocity; and increased resort to unilateral retaliatory approaches to secure changes in the policies and negotiating positions of weaker trading partners.

210. Policy issues in the 1990s regarding market access conditions are likely to be influenced by the results of the Uruguay Round in several respects. Much will depend on the extent to which the Round results in more liberal and secure conditions of access. These must include specific tariff concessions, and non-tariff liberalization favouring developing country products in the markets of developed countries, the elimination of "grey area" measures such as voluntary export restraints, and tighter disciplines on anti-dumping and countervailing measures. Trade liberalization is particularly needed in such sectors as agriculture, textiles and clothing, tropical products, and natural resource-based products.

211. Overall, stronger multilateral principles, rules and disciplines which reduce the possibilities for restriction or harassment of trade, as well as underpinning and stimulating trade liberalization, must remain a central objective. Such an evolution would have to be based on full respect for the principle of non-discrimination, including the unconditional application of most-favoured-nation treatment and the steady elimination of arrangements for market sharing and managed trade. The prohibition of unilateral action outside the legal framework of the General Agreement on Tariffs and Trade, as well as the maintenance of an effective system of dispute settlement, would be essential.

212. Eliminating protectionism in the developed countries must be complemented by more active policies to facilitate adjustment to structural change. Resisting structural adjustment through protectionism creates long-term problems for the strength and competitiveness of the productive base of those countries themselves. It also has serious adverse consequences for the export prospects of their trading partners, including those in the developing world. The interests of the developed countries, in the long run, lie in taking advantage of opportunities for an improved international division of labour to promote the orderly transfer of capacities from areas of low productivity to areas better suited to their factor endowment. If industrialized countries do

not allow increasing imports from the developing world to replace parts of their own production, they also forgo the chance of expanding their own exports, because the import capacity of developing countries will be constrained. Besides, lower cost imports from developing countries increase the real incomes of consumers in developed countries.

213. The implementation of the commitments contained in the Final Act of UNCTAD VII to advance structural adjustment as well as to halt and reverse protectionism will have to be intensified. It has become more urgent for Governments to pursue the establishment of transparent national mechanisms to evaluate protectionist measures sought by firms/sectors and their implications both for the domestic economy as a whole and for the export interests of developing countries. Subsidies for production and exports which cause major distortions in the world economy and misallocations of resources should also be steadily eliminated. International cooperation is essential to reach agreement on the global requirements of adjustment and to pursue coordinated policy moves to speed up the adjustment process.

D. Improving the international trading framework

214. As recognized at UNCTAD VII, a key objective of the Uruguay Round is to preserve the basic principles and further objectives of the GATT, and to develop a more open, viable and durable multilateral trading system. The recent decision to restart the Round following the setback at the Ministerial Meeting in December 1990, represents a reassertion of the political will of participating Governments to see the negotiations through to a successful conclusion. The dual challenge of the process is to attract the full adherence of stronger trading partners, whose autonomous actions can undermine the system, and to make the system more responsive to the needs of weaker partners. A positive outcome which meets this challenge will be a decisive blow against protectionism and possible fragmentation of the trading system, and will counter recessionary tendencies in the world economy.

215. The resumption of the Uruguay Round has provided a fresh opportunity to consider new means of strengthening and revitalizing the multilateral trading system in ways that both satisfy the vital interests of all participants and take full account of the development dimension of the issues under negotiation. In addition to improved access to markets for products of developing countries, this dimension involves the design of new rules and disciplines consistent with their economic, social and development objectives. These objectives include, notably, the need of these countries to build the infrastructure of development and international competitiveness, and to pursue legitimate national development policies without fear of retaliation or discrimination. If the opportunity is missed, multilateralism will suffer a severe blow, paradoxically at a time when the trading system is becoming more universal.

216. The broad scope of the Round, extending beyond the frontiers of traditional trade policy to embrace issues in the field of services, investment and technology policies, calls for a coherent and integrated approach supportive of national development efforts. Tangible progress has already been registered on a number of fronts - including, for instance, the mechanisms for dispute settlement and trade policy review - which should help

strengthen the General Agreement. But a final agreement which failed to take fully into account the development dimension would be incompatible with the accepted goal of achieving a positive and balanced outcome.

217. Such an outcome will require genuine efforts to resolve outstanding political and technical problems which exist in practically every negotiating area from market access to institutional issues. The technical complexities will present a formidable challenge, in particular in such areas as market access, agriculture, rule-making, services and in textiles and clothing, where consensus is needed on modalities for reintegrating this sector into the GATT. The negotiations will also need to address the institutional implications of the Round and the implementation of its substantive results taking into account the concern that this should not create links between the rights and obligations contained in the various instruments.

218. While individual countries have their particular sets of priorities, a balanced outcome would have to meet a number of criteria that are crucial if it is to provide concrete benefits for developing countries. These include:

(a) Substantial concessions on market-access issues in order to promote trade liberalization and to expand the opportunities for developing-country exports to world markets, while providing adequate compensation for the erosion of preferences under existing schemes;

(b) Reformed GATT rules on agriculture which provide developing countries with improved and secure access to markets, recognize the developmental role of agriculture in the economies and societies of developing countries and mitigate negative impacts on net-food importing countries;

(c) An agreed programme for phasing out the MFA and for reintegrating trade in textiles and clothing into the rules and principles of the General Agreement within a reasonable time frame;

(d) The fullest possible liberalization of trade in tropical products on a non-reciprocal basis;

(e) An agreement on safeguards that imparts stability and predictability to international trade and excludes the possibility of discriminatory action in conflict with the MFN principle. This should be complemented by a refinement of the rules governing the application of anti-dumping and countervailing measures so as to reduce the scope for harassment of developing-country efforts;

(f) The acceptance by all parties of tighter disciplines over their resort to trade policy measures on a mutual and equitable basis, taking into account the importance of flexibility (especially in relation to balance-of-payments problems in the context of development strategies) as well as levels of development;

(g) An agreement on trade-related aspects of intellectual property rights (TRIPS) that facilitates the access of developing countries to technology and their pursuit of public policy and social objectives;

(h) A multilateral framework on trade in services which assists in enhancing the international competitiveness of developing country services firms and in enabling them to gain effective access to world markets through, inter alia, incorporating the MFN principle and universal coverage of the services sectors;

(i) An agreement on trade-related investment measures (TRIMS) which clearly recognizes the right of developing countries to establish conditions for foreign investors intended to promote development and enhance competition, so long as such measures do not cause injury to trading partners;

(j) A legal structure for the implementation of the results of the Uruguay Round which precludes both unilateral action and cross-sectoral retaliation between trade in goods and measures relating to intellectual property protection, investment and services, and which does not undermine the scope for developing countries to effectively pursue their trade and economic interests.

E. Institutional implications of the Uruguay Round

219. The search for an institutional framework adequate to the implementation of the expected results of the Uruguay Round has focused attention on the incompleteness of institutional arrangements governing international trade relations. GATT and UNCTAD were responses to the failure to agree in the 1940s on the establishment of a comprehensive international trade organization. Such an organization, as envisaged in the Havana Charter of 1948, would have dealt, inter alia, with questions of economic development, foreign investment, restrictive business practices and the problems of commodities, as well as the issues of commercial policy incorporated in the GATT. Consequently, when UNCTAD was set up, it was mandated to study matters related to the establishment of such an organization. This issue was discussed at sessions of the Conference until UNCTAD VI. It has resurfaced, with somewhat different parameters, in the Uruguay Round context.

220. Proposals have been advanced to the effect that the outcome of the multilateral trade negotiations should include providing GATT with a more solid institutional basis through its transformation into a new international trade organization. Such an organization would, among other things, be responsible for the implementation of the results of the Uruguay Round, evolve dispute settlement procedures applicable to all multilateral trade agreements, and cooperate on equal terms with IMF and the World Bank to ensure greater coherence in global economic policy-making. The draft Final Act presented to the Brussels Ministerial Meeting envisaged that work would begin towards the conclusion of an organizational agreement which would provide the administrative and institutional base for the legal instruments embodying the results of the negotiations. No agreement has yet emerged on this issue.

221. Meanwhile, the idea of a new initiative towards the establishment of an international trade organization has also been revived in the United Nations. The General Assembly had called for a report by the Secretary-General of the United Nations on institutional developments, taking into account all relevant proposals, related to the strengthening of international organizations in the

area of multilateral trade. This report is to be prepared after soliciting the views of all Governments and Executive Heads of the specialized agencies and other organizations and programmes of the United Nations system.

222. These proposals have many facets which require the most careful examination. Some of them envisage that rights and obligations in the goods sector would be linked with those in the new areas of trade in services, and TRIPS. For one thing, such linkage, if accepted, would expose existing rights and obligations in the goods sector to major new uncertainties. For another, it would legitimize the threat of retaliation by major trading partners, through the curtailment of market access, whenever they perceive signs of restraint by other countries, particularly developing countries, in the new areas At present, this particular form of retaliation is widely accepted as inconsistent with the General Agreement.

223. There are also a number of systemic factors in the evolution of the world economy which affect the international trading framework and which would have to be taken into account in any effort to strengthen the relevant international organizations. Massive capital flows unrelated to trade have tended to generate exchange-rate instability, with adverse consequences for international trade. Huge transactions within and among large transnational enterprises often bypass existing rules and disciplines. Rapid technological development as already noted is having a profound impact on the production and trade of goods and services, and is rapidly modifying comparative advantage based on natural resource endowment. Furthermore, the emergence of trading blocs involving major trading partners could fragment the international trading system if they are not managed with due regard to the basic principles of the system.

224. Another feature of some of these proposals which deserves attention has to do with the desire to achieve greater coherence in global policy-making through strong institutional collaboration between a transformed GATT and IMF and the World Bank. Fears have been voiced that this approach would lead to even heavier cross-conditionality than in the past. More generally, it should be noted that, by virtue of its wide-ranging coordination responsibilities in the economic and social fields under the Charter, the United Nations is ideally situated to promote coherent international policies in the fields of investment, technology, trade, debt, money and finance and the collective management of the world economy. These are areas in respect of which the responsibilities of international institutions are divided and where serious policy inconsistencies are apt to appear.

225. Many of the basic ideas underlying the Havana Charter remain valid. Any new institutional arrangements in the field of international trade should be comprehensive in subject coverage, universal in membership, based on agreed objectives and norms of behaviour, responsive to the interests of all members, equitable in decision-making and organically linked to related institutional arrangements in the areas of money and finance.

226. An organization with these characteristics would provide a mechanism for the international community to develop objectives and policies with respect to international trade and development, within a framework designed to take full account of the interrelationships of the issues involved and their

implications for countries. Its procedures would provide maximum transparency and full participation by all countries in the decision-making process. It should also serve as a forum for international consensus-building as the basis for decision-making and for translating agreed principles into action either by Governments or through the negotiation of contractual multilateral agreements. Finally, it would provide a framework for surveillance and for the reconciliation of divergent positions. Sight must not be lost of these longer-term perspectives in current discussions on the strengthening of international institutions in the area of trade.

F. Environment and international trade

227. One of the major challenges for the 1990s is to evolve an economic policy framework to deal with the interaction between trade issues and environmental policies. How this challenge is met will have consequences for the international trading system and, in particular, for the trade and development of developing countries. Recent debate has focused on the question of harmonizing environmental standards and regulations. One view is that differentiation should be maintained between countries with respect to environmental standards, depending on the degree of environmental stress and prevailing national or local conditions. Otherwise the international harmonization of environmental standards could erode comparative advantages among countries to the detriment, in particular, of the trade of developing countries. Another view is that in order to discourage the introduction of non-tariff barriers to trade for environmental reasons, the harmonization of environmental standards and regulations should be actively pursued without conditions.

228. Another issue likely to become increasingly prominent relates to the possible use of trade measures in the context of environmental policies. Trade policy-makers, especially in developing countries, are concerned that major trading countries may resort to such measures to enforce global environmental policies. There is concern too that differences among countries in environmental regulations may generate political pressures in developed countries for compensatory trade-policy actions. For instance, countervailing duty laws could be reinterpreted in such a way as to offset cost differences arising from differing environmental standards.

229. To prevent their use as a vehicle for introducing discriminatory measures and disguised barriers to trade, the deployment of trade policy measures for environmental purposes should as far as possible be avoided. In general, greater reliance should be placed on the negotiation of international conventions and/or treaties binding on all signatories. Adequate policy responses to global environmental threats, such as for example the proposed tradeable permit scheme already mentioned in the preceding chapter to counter the build-up of carbon emissions, would reduce the temptation to deploy trade measures for environmental purposes. However, should trade measures be found necessary for the enforcement of internationally agreed environmental policies, certain principles and rules should apply.

230. These include: the principle of non-discrimination; rules governing the appropriate use of trade measures for environmental purposes; the principle that the trade-restrictive effects of new environmental standards should be proportional to the legitimate objectives of these standards; an obligation to ensure transparency in trade measures related to environment and to provide adequate notification of national regulations which are not based on international environmental standards. Effective dispute settlement procedures would also be required.

231. Owing to the heavy burden of debt servicing and to low commodity prices, some developing countries have been obliged to adopt export policies which have led to overexploitation of natural resources, including arable land, and in consequence to environmental damage. Sustainable development would obviate the need for such export policies; it calls among other things for appropriate technical and financial assistance to developing countries for the purpose of sustainable land management and resource exploitation patterns.

Chapter III

ENHANCING THE TECHNOLOGICAL DYNAMISM OF DEVELOPING COUNTRIES

232. The need for developing countries to make the fullest possible use of scientific and technological advances to support their development efforts has become increasingly evident as science-based technologies emerge as prime determinants of economic and social change at the global level. In a highly interdependent global economy, the prospects for the technological progress of developing countries are determined not only by domestic but, increasingly, by external forces, notably the emergence of new technologies, new directions in intellectual property rights protection, inter-firm technological linkages, and the evolution of international trade relations. The growing international concern for ecologically sustainable development has added a new dimension to this problématique.

233. Ultimately, the pace of technological change in developing countries will depend on the extent to which these and other factors influence the decisions of productive enterprises. However, by providing an appropriate domestic policy framework for the operations of their firms, developing country governments can shape their national technological progress in the 1990s. Thus, enhancing the technological dynamism of developing countries will call for a systematic approach to its two complementary sources: the transfer of technology from abroad and domestic technological effort, including the diffusion of its results among local enterprises.

234. The markets for both sources of knowledge are subject to imperfections, the effects of which bear particularly on developing countries. As international competition in the area of technology grew more intense, governments of industrialized countries reacted by strengthening the legal protection of innovations, relaxing anti-monopoly regulations and, in some instances, resorting to trade retaliation to defend the competitive positions of their firms. At the same time many industrial enterprises in these countries entered into strategic alliances in order to spread research and development (R & D) costs and take advantage of complementarities. As a result, knowledge and innovation tended to concentrate in these collaborative networks, to the exclusion of developing country firms.

235. Imperfections in the international market for technology also arise from the inadequacy of information available to technology receivers on sources of supply, costs, reliability, specific conditions for transfer and likely future evolution. Another source of imperfection is inadequate access to information by technology suppliers on local factor and product market conditions and on skill availabilities in the host country. Imperfections in the market for domestic technological efforts are reflected in suboptimal levels of investment by enterprises in R & D and skill formation. Both developed and developing country governments have intervened with varying degrees of selectivity to correct such imperfections.

A. Transfer of technology

236. During the late 1960s and 1970s many developing countries concerned about obtaining fair terms for their technology imports and about promoting domestic

capabilities established guidelines and control mechanisms to influence the terms and conditions for the acquisition of technology from abroad. In the area of foreign investment, they pursued policies which limited the field of activity of foreign enterprises and their share of ownership. A few developing countries also introduced changes in their patent systems designed primarily to reinforce provisions governing the obligation to work patents locally and the duration of their protection.

237. Due in part to the stagnation of technology flows associated with the debt crisis, the 1980s witnessed a relaxation of regimes governing technology and foreign investment in these countries. Developing countries which had previously established fairly rigorous screening procedures for technology imports, now introduced policy changes aimed at easing controls over the licensing of patents and trade marks. This evolution reflected first, a more sophisticated assessment by host country governments and by foreign investors and technology suppliers of the importance of foreign technological collaboration in developing country economies; and second, the perception that national enterprises in developing countries have acquired improved bargaining capabilities in the negotiation of contracts.

238. Particularly interesting in this context was the approach followed by the Republic of Korea (and earlier by Japan). This approach entailed allowing local enterprises to acquire technologies of their choosing, and to pay such prices as they deemed consistent with their commercial interests for new and/or valuable product and process technologies. At the same time, these enterprises were provided with systematic information on sources and prices of technology, and with advice and assistance on bargaining tactics, restrictive practices, warranties and the scope of proprietary rights. Rationality was thus enhanced both by better information and by the inevitable exposure of these firms to domestic or foreign competition. The freedom enjoyed by technology-importing firms to make mistakes was disciplined by the knowledge that they would have to bear the consequences of their own imprudence.

239. The liberalization of the foreign investment policies of a number of developing countries involved inter alia measures to protect foreign investors against nationalizations; reduce limitations on ownership shares, field of activity and size of profit remittances; and accept international arbitration as a means of settling disputes between the parties concerned. These reforms were essential in conveying the receptiveness of host country governments to foreign investment. Some countries went further and offered to provide fiscal and other incentives such as supplementary protection from import competition and special access to facilities.

240. These and other incentives for foreign investment can be useful in furthering development objectives where they are aimed either at offsetting disincentives arising from market distortions or in guiding activity into areas where the public interest is greater than is reflected in projections of the private profitability of investments. Highly valued or environment-friendly technologies are examples. Experience shows however that where these incentives are not part of a broader technological policy with clear priorities, they may result in inefficiency and misallocation of resources,

and risk generating net losses for the host countries. Some developing countries, driven by lack of external financial resources and competing to attract foreign investors, may well be exposing themselves to such risks.

241. Experience has also shown that the most effective and efficient inducements to foreign investors and technology suppliers generally include those arising from financial stability, policy transparency, the availability of skilled manpower and large and dynamically growing domestic markets. The presence of these parameters and the degree to which governments have control over them vary widely among developing countries. In particular, over the past decade, serious financial constraints have outweighed the effects of favourable legislation in the attempt to attract foreign investment and technology flows in most developing countries. The removal of such constraints through debt relief measures, the restoration of new lending, and expanded official flows would permit the rebuilding of the presently depleted stock of productive capital, stimulate a greater volume of investment in new technology and improve the ability of these countries to maintain or achieve international competitiveness.

242. From the technological point of view, an advantage of foreign direct investments is that they can bring in skills and knowledge not available in the country. The disadvantage is that they may also bring in or replace skills that already exist or could be efficiently developed by local enterprises. The need therefore is for policies that systematically provide greater incentives to those investments which introduce knowledge or inputs not available in the country and are unlikely to be developed domestically.

243. Strengthened protection of intellectual property rights has been urged on developing countries by their trading partners as a further incentive for foreign investment and, more generally for the transfer of technology. Such protection may be a necessary condition for technology transfer associated with patentable products and processes. Yet most patents registered in developing countries are unexploited in terms of leading to domestic production. Besides, stronger intellectual protection will not by itself offset a lack of trained personnel, of equipment and general infrastructure, and of proximity to major research countries that are key factors in the location of R & D facilities. Nor will technology transfer actually occur, unless other conditions are met, including for example adequate market size and expected growth and the competitive ability of potential licencees. These considerations suggest that the reinforcement of intellectual property rights protection alone is unlikely to be sufficient to induce additional transfer of technology to developing countries; rather it could lead to higher costs of imported products and a more frequent use of restrictive clauses in technology contracts covered by such protection.

244. Although the volume of technology flows to the majority of developing countries has not risen significantly since the early 1980s, a diversification in the sources of such flows has taken place which is beneficial to developing countries. The dominance of the United States as the major source of investment and technology has given way to the triad comprising the United States, Europe and Japan, to which may be added the role of developing

countries themselves as suppliers to other developing countries. An offsetting factor is that countries in Central and Eastern Europe, which were formerly important sources of technology flows for some developing countries, financed through barter and bilateral clearing arrangements, are now becoming competitors with developing countries for investment and technology transfer. At the same time, the restructuring of their economies could offer new opportunities for technology trade with the South.

245. There has also been a diversification in forms of technology transfer, including licensing and other arrangements, as well as in the types of agents involved in the transfer, such as independent machinery and equipment suppliers and small and medium-sized enterprises. This evolution can be advantageous for developing countries since the wider range of options available strengthens their bargaining position, while the alternative formats may stimulate a more active involvement of domestic firms, thus adding to the accumulation of domestic knowledge and capabilities.

246. Paralleling the trend towards diversification in the forms and sources of technology flows to developing countries is another development which will also affect their participation in international trade in technology. This is the already mentioned emergence of international networks or strategic alliances for cooperation and pooling of resources among enterprises in R & D, skills, procurement, manufacturing testing and marketing. An important question is the availability in developing countries of the infrastructure and the human and financial resource base necessary to gain access to these international technology networks. There is the question also of the new policy approaches which would be needed to enhance the future prospects for developing countries to benefit from emerging international technology networks. The resumption of the negotiations of an international code of conduct on the transfer of technology, if adapted to these changing conditions, could facilitate the emergence of a common set of principles to serve as a basis for international cooperation in this domain.

247. The richness and complexity of the present-day pattern of relationships in international technology trade also argues for the elaboration of new mechanisms for revitalizing the transfer of technology to developing countries. The coverage of these mechanisms should include packaging technology, financing and risk-sharing in ways that satisfy the requirements of different types of suppliers and receivers of technology while promoting technological dynamism.

B. Domestic capabilities

248. The quality and intensity of domestic technological effort is the other main determinant of technological dynamism and international competitiveness. Such effort is necessary to enable enterprises to absorb and efficiently deploy new technologies, adapt them to local conditions, improve upon them and ultimately create new knowledge. Technological dynamism and the pace of industrialization have differed widely among countries. A major factor has to do with the interaction of national policies with global economic forces and the capabilities of firms. Investment in the acquisition of capabilities, as with other kinds of investment, depends strongly on the incentives arising

from the markets that enterprises face. Stability, growth and a predictable policy framework are essential to investment in capability building, but the economic disorder afflicting the majority of developing countries over the past several years has been highly uncongenial to these objectives.

249. Competition, both domestic and international, in an efficiently functioning market setting also provides a powerful incentive for technological effort. Policy reforms are widely recognized as necessary in many developing countries both for the pursuit of efficiency and growth and for investment in technology. But as pointed out earlier in this report, the outcomes of the policy shifts actually pursued have been mixed and uneven. Thus, the full force of competition from mature enterprises abroad, which is brought into play by drastic trade liberalization, can prevent new local entrants in developing countries from acquiring a base of technological capability. This possibility reinforces the "infant industry" case for providing protection for nascent industries during the learning peirod. Yet, protection that is excessive, prolonged and not supported by measures to reduce costs external to the protected activity can stunt the process of developing competitiveness in world markets. Hence the need for a balance between exposure to market competition and protection from exposure for a reasonable period of technological learning and maturation.

250. Even with optimal incentive structures, technological dynamism at the level of the firm is not generated in isolation. It entails intense and continuous interaction with the industrial environment. This environment is responsible for providing the human and financial resources needed for capability development, determining the extent of specialization and supplying a number of public goods and other forms of institutional support. Thus, national technological dynamism is a synergy arising from the interaction of enterprises, markets and institutions. The most effective policy interventions in support of technological dynamism are those which provide inputs which firms are unable or unwilling to provide themselves or which help reduce risk or uncertainty associated with certain types of investment in the accumulation of knowledge and new skills.

251. In contrast to developed and the more advanced East and South-East Asian developing countries, very little R & D in the majority of developing countries takes place in productive enterprises. Moreover, the performance of publicly-funded R & D laboratories in developing countries has fallen short of expectations. Even where innovation and research outputs are high in relation to the allocation of human and financial resources, improved products and processes often fail to make a significant impact on industry.

252. One reason is that such research has not adequately focused on the needs of domestic manufacturers. A possible remedy lies in refocusing R & D activities by concentrating on selected technical areas in line with actual and future demand. Such measures might include increased emphasis on single-purpose instead of multi-purpose research, higher priority for technical services as opposed to basic research, and measures to enhance the demand orientation of R & D activities, such as the promotion of contractual research, fee-based incentive schemes and risk sharing schemes.

253. Industrial history shows that the promotion of scientific and technological advance depends significantly upon the nature of the inter-linkages between educational systems, institutions and firms. While the differing historical backgrounds and technological capabilities of developing countries make it difficult to propose generally applicable strategies that encompass all relevant elements, efforts to promote and strengthen such inter-linkages clearly bear a high potential. In addition to an enhanced demand orientation for publicly funded research, closer collaboration between universities and firms, as well as among firms, would provide an important stimulus for technological development.

254. A number of policy instruments have been used, particularly in the developed market economy countries, to support greater investment by enterprises in R & D with the aim of promoting innovation. These include financial support, either in the indirect form of tax credits to firms for incremental R & D expenditures or direct financial assistance through the provision of loans, grants, and risk sharing investment. They also include intellectual property rights protection, mainly for patents and copyrights. Developing countries, on the whole, lack experience in utilizing financial support measures to promote enterprise-level R & D. They will require assistance from bilateral donors and international institutions in framing and implementing such measures so as to tailor the promotion of R & D efficiently to existing levels of technological capability and national requirements.

255. Developing country firms should be given opportunities to participate in the R & D networks, which as already noted have been established to cope with the large risks and economies of scale associated with more advanced technologies in the developed market-economy countries. Such opportunities would be particularly important in such areas as biotechnology where there is need to adapt innovations to specific developing country conditions. Exchanges of R & D personnel between countries would also help to deepen the capabilities of developing country firms. Intensified economic cooperation and regional integration among developing countries in the coming years would enlarge the possibilities of greater technical and R & D cooperation in areas of common interest, thereby spreading overhead costs and avoiding duplication of efforts.

256. Intellectual property rights protection raises special problems for developing countries. The economic rationale for it in general is the expectation that while the increased costs of the technology to users gives rise to slower diffusion, this will be more than offset by the growth and productivity-generating effects from encouraging investment in R & D. Until the negotiations on TRIPs in the Uruguay Round got under way, the commonly accepted international legal principle for protection of intellectual property rights was the right of each country to adopt the intellectual property regime of its choice, balancing the two types of effects just mentioned, in relation to the existing level of technological development. The application of uniform and substantively higher standards of protection across all countries would tend to discriminate against users as distinct from producers of technology in both developed and developing countries.

257. Being overwhelmingly net users, developing countries would, as a result, bear higher costs for technology in areas subject to protection. At the same time, the benefits that they would derive from technology generation will not accrue until such time in the future as their firms have achieved the capacity to produce patentable inventions. No less important are the implications for technological development. In countries that have already attained a certain degree of industrial and technological development, intellectual property protection may well be an important tool in fostering innovation, to the extent that it ensures the exploitation of R & D results through the vehicle of exclusive rights. In other countries however, strong systems of protection (going far beyond arrangements to suppress counterfeiting) may, by working against broad based diffusion through free market competition, limit the possibility of following a path of technological development based on reverse engineering, adaptation and the improvement of existing innovation. In any overall agreement on TRIPs, developing countries will need to retain adequate flexibility to take their specific technological circumstances into account in fashioning their intellectual property protection regimes.

C. Environment and technology

258. Technology has a strategic role to play in determining the future state of the global environment. If total world output were to double or treble with the application of the technologies that currently prevail in energy production, transportation, manufacturing, agriculture and other sectors, future generations would probably experience a sharp deterioration in climate, health and productivity. Technology is thus both a major source of damage to the ecosystem and it is also a potential solution to the apparent conflict between increased material prosperity for all and improvement in environmental quality.

259. The knowledge required for reducing the emission of pollutants, wasteful consumption of resources and disruption of natural habitats exists or can be developed and improved. The prospects opened up by recent advances in such areas as renewable sources of energy, mass transit, new materials, recycling and biotechnology attest to the capacity of the scientific and technological base to handle many existing and foreseeable environmental problems. If environment-friendly technologies are not being developed, applied and transferred on a large enough scale to slow down environmental degradation, it is because the costs and benefits of many production decisions affecting the environment do not accrue to, or are not perceived, by the decision-makers. To remedy this situation, policies would have to be put in place to make these costs and benefits explicit and stimulate enterprises and other economic agents to deploy clean, natural resource-conserving technologies.

260. The increasingly global character of many contemporary environmental problems provides both developed and developing country governments with a strong interest in establishing the necessary framework for promoting these technologies. However, if the imperative for action is to carry conviction with the rest of the world, the developed market-economy countries will have to demonstrate their readiness to apply modern knowledge to the improvement of living standards in the developing world and at the same time to modify lifestyles associated with the use of the destructive production and consumption technologies that are currently dominant in the North.

261. Promoting the use of environmentally-sound technology in developing countries raises several issues, all of which underline the imperative of stronger partnership between developing and developed countries in the area of technological development than has characterized their relationships over the past decade. First, the conditions for the successful application and development of such technology in developing countries are much the same as those for technology generally. The greater a country's existing knowledge and skill base the greater the ability of its enterprises efficiently to select, use, adapt and modify imported technology, including the hardware component of more environmentally-benign technologies. Environmental concerns strengthen the case for promoting the development of human resources, and more generally, the technological dynamism of developing countries. Accelerating the present low rate of investment relative to the existing capital stock in many developing countries is essential for the rapid diffusion of new, ecologically-sound technologies.

262. Second, the focus of domestic environmental concerns in developing countries differs from that of the developed. The tendency in developing countries, beset by the immediately pressing needs of their populations and by economic stagnation, has been to concentrate attention on those environmental problems having immediate consequences for the health or livelihood of their people. Their priority requirement is for resources to finance investment in technologies for environmentally-sound economic development. Third, and as already discussed, the resource requirements of developing countries will have to be highly concessional in order to support the added cost of importing environmentally-sound technology and of developing the capacity to assess and take decisions on the environmental impact of technology. In particular, additionality in concessional financing, such as that provided for in the recently-created Global Environment Facility, is crucial if developing countries are to divert resources towards such global problems as ozone layer depletion, global warming, loss of biodiversity and the pollution of international waters.

263. Fourth, although clean technologies are available and generally part of the public domain, information about them is not universally accessible. More effective arrangements for the dissemination of information on existing environmentally-sound technologies and on the environmental risks of technologies currently on the international market are needed to assist decision-making in developing countries. Fifth, it is difficult to assess the extent to which the availability of environmentally-sound technologies in developing countries might be impeded by intellectual property rights protection. Where the process or product know-how is patented, adequate protection is essential if the cooperation of the patent-holder must be sought in order to make effective use of the technology. However, given the growing community of interest that exists in protecting the global environment, principles, such as compulsory licensing, would have to be worked out to ensure that the price of such technologies provides an incentive to generators and is equitable to users. Sixth, the specificity of environmental conditions in individual developing countries, together with their weak R & D capacities, reinforces the need for mechanisms to channel greater R & D to these countries and to promote increased R & D collaboration on their technological problems.

Chapter IV

MAXIMIZING THE CONTRIBUTION OF SERVICES TO THE DEVELOPMENT OF DEVELOPING COUNTRIES

A. Services in the development process

264. Services sectors such as transport, communications, banking, insurance, health and education, which represent basic social and economic infrastructures, have traditionally been important for the functioning of economies. But the recent surge of interest in services has been due to the stronger recognition of their strategic implications for vital national political interests and for growth and development. Key transportation and communications services have an important bearing on national security, and certain services such as the media and financial services, as well as communications, are considered major factors for the maintenance of national policy autonomy, identity and culture. As for growth and development, the experience of the developed-market economy countries, in particular, has shown that some services, particularly producer services and those associated with information technologies, are crucial for the dynamism of the entire economy. Such services are a major source of value-added and a determining factor of international competitiveness in a wide range of other services as well as goods. The strengthening of modern services in developing countries where producer services and telematics are much less evolved has accordingly emerged as a major development task with substantial consequences for international trade in services.

265. In addition, services are increasingly providing a vehicle for the development of human capital and the upgrading of employment opportunities as well as for generating, absorbing and assimilating technological innovation. Furthermore, they influence the location of production facilities, investment and decision-making functions. Enterprises have sought to enhance their position vis-à-vis competitors through acquiring control of services at the various stages of conception, design, production, marketing and distribution. All these factors help to explain the intensity of the international debate on services and current responses to initiatives by some countries to improve the ability of their national firms to penetrate foreign markets for services.

266. International service transactions can assume a variety of forms involving the transborder movement of goods, persons, capital and information. Goods can cross borders to receive a service (such as repair and processing services) or to provide a service (such as the international leasing of machinery or chartering of transportation equipment). Persons can cross international frontiers either to provide services (such as labour services and consultancy services), or to receive services (as in the case of tourists, patients seeking health care abroad, and students going abroad to study). Capital can be involved in the provision of a service, including for example through the establishment of agencies abroad. The flow of information across borders - transborder data flows - is a service in itself and is an essential ingredient contributing to the internationalization of many other service activities.

267. The last decade has witnessed rapid growth in international trade in services. This reflects for the most part trends in the developed market-economy countries, where services have come to provide the majority of new employment opportunities. Services now account for between one half and two thirds of GDP in these countries, and the service sector has been growing in parallel with the manufacturing sector. The fastest growth in both production and employment is now to be seen in the producer services sector, which is directly supportive of manufacturing. Within this category, which includes a variety of service inputs at various stages of production, there is a trend toward externalization, in that services formerly provided within firms are now purchased from outside suppliers. Information technology has enhanced the provision of many, if not most, services and has itself spawned a whole new data service industry.

268. In a number of developing countries construction, tourism, labour services and some professional services have become significant sources of foreign exchange earnings. A few developing countries in East-Asia stand out as competitive exporters of both services and manufactures. Most developing countries however are in deficit in their services trade, which aggravates their balance-of-payments difficulties. While services in these countries account, as in developed market-economy countries, for a sizeable proportion of GDP, the expansion of their services sectors has been associated with phenomena such as urbanization, population growth and the inability of the goods producing sectors to absorb new entrants into the labour force.

269. Growth in the services sectors of these countries has thus been concentrated in low-productivity services, including those in the informal sector. These sectors in general are not effectively integrated into the production process. Nor can existing capabilities provide all the services required by other sectors of the economy, particularly those incorporating specialized expertise or even those linked to trade in goods. Consequently, these countries are constrained in their ability to participate effectively in the emerging international division of labour in services and to enhance their international competitiveness in several other sectors. Furthermore, they do not possess the corporate structures and informational networks necessary for the delivery of many of their services to world markets.

270. For a growing number of developing countries, tourism is providing a major source of foreign-exchange revenues. Countries wishing to expand their foreign exchange and income generation from this sector will have to take into account the problems and opportunities arising from the increasing dependence of the world tourism industry on the flow of information. Many developing countries, including those relying on tourism, also receive considerable income from labour remittances, which together help compensate for deficits in their goods and services trade. In effect, these countries export labour services and are thus dependent on the vagaries of the economies that are hosts to their nationals and on their employment and immigration policies. Several such countries have recently been faced with the need to reabsorb huge numbers of migrants and to generate new sources of foreign exchange. One challenge facing these countries is to channel the acquired skills of returning migrants into new service exports which could help offset lower labour remittances.

271. Information technology has permitted interaction between producers and consumers of services at a distance through the medium of transborder data flows. They can be used to deliver a wide variety of services to customers abroad, particularly information intensive services such as banking services, product design, and access to information stored in data services. Such flows provide competitive support to service firms and constitute a vital tool for the management of geographically dispersed corporate systems. This factor has led to a predominance of transnational corporations in this field. Many of the issues that arise in connection with the role of service transnational corporations also have implications for transborder data flows. The policy issues relevant in this context include the extent to which data services should be imported via transborder data flows or whether an effort should be made to develop them domestically, the role assigned to various kinds of firms in this development (domestic private firms, public entities, or foreign investors), the need to decentralize knowledge-intensive services and decision-making functions within corporate structures and the design of suitable regulatory regimes.

B. Strategies for the development of services sectors

272. Many developing countries recognize the importance of comprehensive services strategies which take into account the interrelationships between the services and the manufacturing and agricultural sectors. Such strategies would aim not only at increasing the competitiveness of the services sectors, but also at increasing their support to efficiency, productivity and competitiveness in other sectors. Some developing countries are already giving priority to expanding the contribution of the services sectors to foreign exchange earnings by negotiating improved access to foreign markets and by pursuing export-oriented service strategies. Furthermore, the upgrading and expansion of employment opportunities through policies directed towards the services sectors have been identified as a principal objective in many countries.

273. The strengthening of the services sectors of developing countries should include a special focus on human capital formation through the development of knowledge-intensive services, usually found in the producer service sector and linked to information technology. A key element in this process is to render the service and manufacturing sectors more mutually supportive. Policy measures directed to the service sector in developing countries should be seen as complementary to, and not an alternative to, the process of industrialization, although for some countries the expansion of services might provide a substantial stimulus to development and growth.

274. Since, in most developing countries, employment is a paramount consideration, the services sectors can be expected to remain an important source of labour absorption and the key to integrating marginalized elements of the population, including those working in the informal sector, as well as providing employment to nationals returning from service jobs abroad. These sectors can also provide increasing opportunities for the upgrading of skills.

275. There are many unexplored opportunities to develop new service exports in developing countries. In encouraging such exports, governments could benefit from the experience of those countries which are already applying a variety of export strategies. A common element in these strategies is that of building on expertise, experience and knowledge that already exist; the knowledge and expertise accumulated in the production and export of agricultural or mineral products can be externalized through new corporate structures and exported. Experience in trading can be consolidated and applied to the service sectors through the establishment of modern infrastructures and a mutually supportive mix of service enterprises and industries. Advantages and experience in tourism can be expanded to cover medical, business or educational services. The rapidly growing trade in information services can offer new possibilities, particularly in the more labour-intensive segments of such services, which would also help improve the competitive position of other goods and services.

276. The formation of human capital and its efficient application in the service industries requires an effective infrastructure. An advanced telecommunications system is essential for the effectiveness of transportation, education, financial, informatic and other infrastructures.

277. Decisions regarding whether countries should rely on foreign participation in the service sector or should reserve particular sectors for national producers cannot be isolated from considerations relating to the strategic role of services and national development objectives. Foreign direct investment could, however, enable developing countries to strengthen their domestic service sectors and to become competitive producers of some services, if such investment meets overall development objectives, including access to foreign know-how and upgrading domestic skills. Subject to the development priorities of countries, comprehensive strategies for the services sector should include measures aimed at expanding the contribution of foreign direct investment to these objectives.

278. Greater attention to services in integration arrangements among developing countries at the regional and subregional levels can serve to expand service exports, while also facilitating intraregional trade in goods. Pooling resources can also lead to common efforts at improving skills and infrastructures and in making more effective use of extraregional imports of services.

279. In the light of these considerations national services strategies could include the following elements:

(i) the development of indigenous producer services and their integration with the adoption and application of advanced technologies in various sectors of production;

(ii) human resource development involving improved educational facilities in relevant areas as well as the provision of adequate on-the-job training arrangements, especially by foreign service suppliers;

(iii) the modernization and expansion of telecommunications infrastructures;

(iv) measures to improve the efficiency and cost-effectiveness of domestic service production, including the creation of services sectors and infrastructures which, together with appropriate incentives, would also serve to attract investment in both services and manufactures;

(v) policies to upgrade the quality of services to acceptable international levels;

(vi) measures to ensure that the operations of the transnational firms in the services sector contribute to objectives such as the transfer of technology and development skills, the strengthening of infrastructures and access to information networks and distribution channels;

(vii) measures to promote competition and to encourage TNCs to externalize services in developing countries and to purchase from domestic service suppliers in developing countries;

(viii) the formulation of effective export strategies as well as appropriate export promotion measures such as tax incentives, relaxation of foreign exchange regulations and duty-free imports of essential equipment;

(ix) measures to encourage the formation of integrated national corporate entities capable of providing services in foreign markets;

(x) action to strengthen the governmental infrastructure to support effective participation in negotiations on services at the regional and multilateral levels;

(xi) enhancing cooperation with other developing countries at the regional and subregional levels, including mutual trade liberalization, pooling capabilities to improve skills and infrastructures for the promotion of exports to third countries, and making more effective use of extraregional sources of imports.

C. International policy considerations

280. The Uruguay Round has been aimed among other objectives at providing a multilateral framework for trade in services which would expand such trade under conditions of transparency and progressive liberalization and contribute to the economic growth of all trading partners. The negotiations have been dealing with a number of issues mentioned above, including access to markets in the context of the objectives of national legislation, as well as the frontiers between trade in services on the one hand, and investment and immigration policies on the other. Since the development of developing countries has been recognized as an objective of the proposed framework, it is to be expected that it will address development issues directly and not as special treatment for developing countries in the form of derogations from general rules and principles.

281. Liberalization measures emerging from the Round should accordingly give adequate attention to services sectors of special interest to developing countries, including equal treatment to those modes of delivery in which these countries have a competitive position such as the movement of persons across borders to supply services, and effective access to and participation in information networks. They should also specifically address the variety of obstacles, regulatory and non-regulatory alike, that these countries face in gaining access to world service markets. They should in addition take into consideration the impact of service imports on development and recognize the importance of ensuring that improved access to the markets of developing countries will be such as to enhance the contribution of these imports to the achievement of national development objectives. Such objectives generally give a prominent place to the establishment of a stronger service sector which, in itself, could attract domestic and foreign investment.

282. One of the purposes of an agreed multilateral framework should be to provide a set of rules and principles that would help increase the contributions of both imports and exports of services to the development process and serve to reduce the possibility of disputes between trading partners on service issues. This would facilitate the task of managing potential conflicts of interests with transnational corporations so as to enlarge the overall contribution of services to development and maximize the positive inputs of those corporations to the process.

283. Another principle that should be embodied in a regime to govern international trade in services is that the access of developing country firms to advanced technologies and training, as well as information networks and distributional channels is essential for the liberalization of trade in services. Provision should be made for the elimination of measures that impede or limit free choice in the acquisition of technologies. The regime should be based on unconditional, most-favoured-nation treatment and universal coverage so as to facilitate a balance between concessions by developing countries and effective access to markets for their service exports. Arrangements for national treatment as well as market access should take fully into account the degree of competitiveness of developing country service suppliers in the various sectors and subsectors, and the prospects of concrete benefits accruing to those countries from the inflow of services from developed countries.

284. As already indicated, access to international markets in services sectors which involve the movement of persons as providers of services is of special importance to many developing countries in enhancing their exports of services. Such access is severely hampered by stringent visa regulations, work permit restrictions and varying professional requirements in different countries. The competitive advantage of firms from developing countries in a number of these sectors lies in a combination of relatively high skills and relatively low cost. For example, construction firms from some developing countries have already become internationally competitive by combining access to low-cost labour with management and design capabilities. In other areas, requiring advanced skills, such as professional services (including engineering, medical and legal services), developing countries may have the potential to capture a significant share of the world market. Another case in point is software services where direct contact with clients is particularly

important and where trade involves cross-border mobility of service producers. Service exports from developing countries, including after sales service, could be enhanced if under a new international regime for trade in services, developed countries would permit firms and professionals from developing countries improved access to countries for the purpose of providing specific services.

285. Furthermore, a large number of developing countries could benefit from the extension of non-reciprocal preferential entry in certain service sectors, such as air transport, and professional services. The financial service sector is of particular sensitivity given the vulnerability of the financial institutions of developing countries and the potential impact of the operation of large transnational financial entities on the implementation of their monetary policies. Recent events have underlined the legitimacy of the concerns of developing countries as regards the need for effective prudential regulation.

286. However, the liberalization of trade in services will not by itself be sufficient to resolve the main problems faced by developing countries in maximizing the contribution of the services sectors to their development processes. International cooperation wll be required to assist their efforts to improve their capacity to secure a significant portion of the rapidly increasing component of service value added in the world economy. International cooperation will also be essential for developing countries to develop their own knowledge based service industries adequate to sustaining innovative, flexible and competitive production capacity in both goods and services. As already noted, developing countries need in particular to develop a domestic producer service sector and supportive telematic infrastructure, to build up appropriately skilled human resources, to reorient skilled manpower returning from abroad so as to continue their contribution to foreign exchange earnings, and to break into markets hitherto closed to developing country firms. Their efforts in this regard merit the strong support, including financial support, of the international community.

287. The vital contribution that advanced technology can make to competitiveness in most services sectors, including both traditional areas, such as insurance and shipping, and new information intensive producer services has already been discussed. The increased participation of developing countries in international trade in these services depends on their ability to strengthen their technological capacity and upgrade their human capital. This requires improved arrangements for access to technology, including the provision of technology by foreign service suppliers benefiting from market access concessions, more focused educational programmes and on-the-job training facilities.

288. Access to information networks and distribution channels is recognized as essential for the effective expansion of exports by developing country firms and in particular for their participation in such services as air transport, banking and tourism. Trade strategies based on information networks are being evolved in virtually all service sectors, and access to such networks has become closely linked to access to the technology deriving from them. The competitiveness of developing country firms would be enhanced by the development of a system of public R & D networks at the world level.

Moreover, in order to benefit from existing opportunities, developing countries should seek to acquire a deeper understanding of networking strategies, through collaboration with the private sector.

289. The modernization and expansion of the telecommunications infrastructure is another prerequisite for the efficiency of services in most developing countries. Given the capital requirements and technology intensive nature of this sector, the magnitude of investments required to meet the challenge is considerable. Resource constraints create serious dilemmas for developing countries, for instance as between providing utility telecommunications services and modernizing the telecommunications infrastructure so as to meeting the more sophisticated requirements of other services sectors.

290. The increasing use of transborder data flows has already opened up new export possibilities for some countries, and this potential could be fruitfully explored and given priority in the service strategies of other countries. These flows have enabled the relocation of some of the labour-intensive segments of the data services of developed countries to some developing countries, including computer programing and the production of software. However, the extremely uneven distribution of the infrastructure necessary for using transborder data flows in the provision of services to world markets represents a serious impediment to the progress of developing countries in this respect. This is one area where massive international assistance is necessary and where the special situation of developing countries would have to be recognized in the design of trade liberalization arrangements.

291. Transnational corporations have come to dominate world trade and production in many service sectors such as tourism, construction and engineering, finance, audio-visual and professional business services, in some cases resulting in high degrees of concentration of market power. This evolution in itself can make market entry difficult for developing country firms which are, in addition, hampered by the lack of established reputations. Furthermore, these corporations have followed competitive strategies seeking to obtain a high degree of control over both suppliers and markets. The perception has therefore emerged that the major benefits from the liberalization of trade in services will accrue to the large transnational corporations. Action is required at the international level not only to counter restrictive business practices and foster competition, but also to encourage TNCs to facilitate the growth of developing country firms, by relying on them increasingly for the supply of services as well as by making effective arrangements for the transfer of technology.

292. The ability of developing countries service firms to compete with the TNCs is constrained by their lack of the financial resources necessary to obtain advanced technologies for the purpose of setting up their own networks and distribution systems and establishing an effective presence in foreign markets. International financial flows could facilitate the consolidation of developing country service enterprises and their acquisition of branches and subsidiaries in foreign countries. There is also a need for stronger international support to developing countries in those sectors, such as air transport, where the maintenance of a competitive position involves large capital expenditures.

293. It is envisaged that the process of progressive liberalization will be implemented through future rounds of negotiations within the framework of the multilateral agreement on services. Developing countries may require technical assistance cooperation, beyond the facilities currently available for the Uruguay Round, to enable them more effectively to identify and pursue market opportunities for their service exports. In this context, it may also be noted that effective policy-making with respect to services is seriously hampered by the inadequacy of internationally comparable statistics on trade and production of services.

294. The future evolution of the services sectors in both developed and developing countries will have many implications for sustainable development worldwide. An emphasis on service-oriented growth and export policies may in some cases be more compatible with the imperatives of environmental protection than one based on manufacturing. The objectives of sustainable development would be frustrated if a division of labour emerged in which developing countries were saddled with the environmentally degrading elements of the production chain while developed countries retained the high value, environmentally compatible service components. Furthermore, in some sectors developing countries will require assistance in meeting environmental standards (such as air transport) or in mitigating the environmental impacts of growth (such as tourism).

Chapter V

STRENGTHENING THE COMMODITY SECTOR: PRIORITIES FOR THE 1990s

A. The world commodity economy and developing countries

295. This report has already documented how inimical the evolution of the international commodity economy has been to the economic development of commodity-exporting developing countries. The dominant feature of the 1980s in this field was the prevalence of very depressed real commodity prices by historical standards. Only some commodity-exporting developing countries were able to increase the volumes of their exports to compensate for lower prices. This has been reflected in recurring shortfalls in export earnings and, together with the rapid expansion in exports of basic foods by developed countries, in a declining share of developing countries in world commodity exports.

296. While the debt problem has been extensively discussed and solutions sought for the heavily indebted developing countries, the problem of depressed commodity prices has not received similar attention from the international community. Yet, for the commodity-dependent developing countries the impact of the fall in commodity prices in the 1980s is comparable to that of the increase in their debt-service burden. Indeed, the debt crisis was exacerbated by the commodity crisis while at the same time debt pressures have contributed to a deepening of the problems in the commodity sector. The availability of resources for development is heavily dependent on a substantial improvement of the commodity export earnings of developing countries.

297. The commodity crisis encompasses virtually all commodities and has had a major impact on both developed and developing countries, though it has been very much more severe for the latter. Sustained pressures for supply to exceed demand, even when commodity policy prices continue to fall, were generated by policies of subsidization of production as well as exports, particularly in developed countries, expansion in the range of commodities produced in the more advanced developing countries, productivity improvements and, in certain cases, a contraction in import demand as a result of increased domestic production of similar or competing products. The solution to the crisis requires sound policies in both developed and developing countries. But the success of such policies is crucially dependent on their compatibility and consistency, which can only be achieved within the context of a coherent and effective international commodity policy.

298. Some significant developments have occurred over the past several years. The long-awaited entry into force of the Agreement establishing the Common Fund has been attained. Although the First Account of the Fund remains dormant, the Second Account could, once current operational difficulties are resolved, be a useful supplement to the larger financial effort required in support of a harmonized diversification programme. The International Natural Rubber Agreement has also entered into force and the International Agreement on Jute and Jute Products has been successfully renegotiated. ICAs and study groups continued to evolve although the latter have been confined to a few mineral commodities. New dimensions of the commodity issue are attracting

increasing attention, including the impact of commodities on environmental issues, of health considerations and of measures to control the production and sale of illicit drugs; the effects of technological changes on the production and processing of commodities; and the creation of an enabling environment to promote and facilitate the diversification process.

299. The challenge of the 1990s in the area of commodities is to work out a strengthened commodity policy taking fully into account these new dimensions as well as the structural and other changes that have occurred, which is aimed at achieving open and healthy world commodity markets and at ensuring that commodities contribute effectively to economic growth and development. The need for a concerted approach by the international community for the purpose of improving the functioning of the world commodity economy is increasingly recognized. Wider awareness of the growing complexities of the commodity problématique could well provide a positive impetus which should be exploited.

300. These complexities exist on both the demand and supply sides. The demand for raw materials is affected by the long-run tendency for the consumption of commodities per unit of output in industrialized countries to decrease. However, this tendency could be offset by high rates of growth, in particular in fixed capital investment, and by technological progress which improves the features of, and generates new uses for, raw materials. Changes in tastes and in age structures of populations, as well as health considerations, are altering the composition of the demand for food commodities.

301. With respect to the supply of commodities, the tendency to increase production irrespective of the market situation is influenced by policies for individual commodities geared to specific national circumstances, by technological innovations, and by the difficulties of cutting back total production upon the entry of new suppliers with lower costs. It is also influenced by macroeconomic policies adopted by developing countries in response to pressures on them to service their debt and to implement structural adjustment programmes.

302. Another factor has to do with the actors in the international commodity economy. There is a growing concentration of market power in a diminishing number of enterprises - including transnational corporations - as a result of take-overs and mergers. This has led to increasingly oligopsonistic markets in a situation where the number of suppliers has been increasing. In addition, commodity futures and options markets are more and more part of an international financial network that also encompasses stock, bond and currency markets, with investment and speculative funds moving across them.

303. Realizing the potential for commodity trade among developing countries is complicated by the North-South orientation of traditional trade patterns. But the scope for increasing domestic demand in the South is considerable. Raw material demand in developing countries has been growing in countries experiencing high rates of economic growth, but this has hitherto been met largely by imports from developed countries. Demand for basic foodstuffs in developing countries has also grown rapidly but, despite significant efforts to increase domestic supplies, the boom in imports has depended largely on supplies coming from the developed countries.

304. The emergence of trading blocs in Europe, America, and possibly in Asia and the Pacific adds a further dimension to the commodity problématique. Such blocs may lead to significant trade diversion, but may also create new demand for commodities within these blocs. Changes in the economies of Central and Eastern Europe are also having repercussions on commodity trade. Demand for some commodities may well increase in the long term and market-oriented approaches in these economies should favour cheaper developing-country exports of commodities in primary and processed forms. At the same time, in the short term plants may close down, as a result _inter alia_ of environmental concerns, thus reducing the demand for raw materials. Demand may also decline as plants become more efficient in the longer term. Export incentives and tied aid provided by the developed countries may furthermore foreclose imports from developing countries, and the more efficient commodity producers in the region may become major competitors.

305. Environmental considerations are a new source of influence on the international commodity economy. Governments and the public in both developed and developing countries are placing increasing emphasis on environmental factors in order to ensure the sustainability of development. In the North, the challenge is to restore the environment while maintaining standards of living and productive activities to the extent consistent with that objective. In the South, the challenge is to eradicate poverty, produce more food, increase employment and exports while protecting the environment and preserving the ecological balance. Both developed and developing countries face the common challenge of ensuring that natural resources are wisely managed in the interests of present and future generations.

B. Strengthened international commodity policy

306. The central objectives of international commodity policy have broadly been established by the international community. These include achieving stable conditions in international commodity trade at price levels that are remunerative to producers and equitable to consumers; improving productivity and increasing commodity export earnings, in particular those of developing countries; maximizing overall efficiency in the use of resources, through among other means halting and reversing protectionism and removing distortions to trade; and enhancing the ability of developing countries to manage commodity dependence and to diversify their productive capacity and exports. These objectives were affirmed in Conference resolution 93 (IV) on the Integrated Programme for Commodities, which was reconfirmed at UNCTAD VII. They are also reflected in the Agreement Establishing the Common Fund for Commodities, which entered into force in June 1989, in various international commodity agreements and arrangements, and in the General Principles governing the Uruguay Round of multilateral trade negotiations.

307. The translation of these objectives into implementable measures and actions has been sporadic and no coherent international commodity policy lending itself to full implementation has yet been evolved. Moreover, initiatives at the national level by important actors in the commodity area to fill the vacuum have, in many cases, been inconsistent with these objectives.

308. Current shortcomings in international commodity policy and in corresponding policies for individual commodities were reflected during

the 1980s in: the long delay in bringing into force the Agreement Establishing the Common Fund for Commodities and in making the Fund operational; the widely divergent positions adopted by countries concerning the liberalization of trade in agriculture, tropical products and natural resource-based products in the Uruguay Round negotiations; and the slow progress registered towards horizontal and vertical diversification in the commodity exports of heavily commodity-dependent developing countries.

309. The most significant factor however was the weakening of the content of producer-consumer and producer cooperation in the 1980s. While the 1980s witnessed the emergence of a number of new producer-consumer and producer arrangements, including ICAs without economic provisions and study groups, there was a clear weakening of interest in systematic efforts to agree upon and implement policy actions. Disillusionment with the operations of price stabilization arrangements set in, notably following the collapse of the International Tin Agreement, and weak producer responses to mounting surpluses. The membership of certain commodity arrangements declined, entailing the absence of important actors on both the producer and consumer sides. Budgetary and other financial difficulties hampered the operations of commodity organizations and the establishment of new study groups. As a result of these problems, no marked improvement took place in the transparency of commodity markets.

310. The weakening of producer-consumer and producer cooperation in the 1980s was due to a number of factors. Perhaps the main one was that, contrary to the situation which prevailed in the 1960s and 1970s, international commodity markets were characterized by depressed real prices rather than price instability around an upward trend. As already indicated, the main determinant of depressed prices was over-supply rather than insufficient demand. For the reasons briefly discussed below, the problem of over-supply did not lend itself easily to approaches through producer-consumer and producer cooperation. This situation favoured consumers who were no longer concerned with the issue of security of supplies, and it also led to divergencies amongst producers on the types of cooperative action that might be taken. A further significant factor influencing the policies of countries in this regard was the growing emphasis on reliance on market forces as opposed to government intervention.

311. Structural changes in developed and developing countries also affected producer-consumer cooperation. A huge expansion of production in both groups of countries, resulting from substantially increased productivity and the successful diversification efforts of new entrants, led to important changes on the importer and exporter sides alike and made the dynamics of cooperation more difficult. Moreover, some major actors in international commodity markets became less dependent on specific commodities and consequently less dependent on cooperative action for these commodities.

312. For developing countries, a variety of factors introduced additional complexities. As a result of debt service obligations and the adoption of structural adjustment programmes which called for the expansion of the export sector, developing producer countries came under pressure to expand commodity production and exports. This aggravated the problems of over-supply. For many developing producer countries the economic crisis that they underwent in

the 1980s weakened considerably the chances of meaningful producer cooperation. In addition, certain developing countries became important consumers and importers of a number of commodities.

313. In developed countries, domestic policies and protectionism stimulated production as well as the export of commodities, reduced their imports and led to conflicts both among them and with developing country producers. In addition, some countries in Central and Eastern Europe became major consumers and importers of commodities, mainly under special bilateral arrangements.

314. The formulation of a strengthened international commodity policy must take account of the changed circumstances and identify strategic areas where action can remove the main obstacles to international cooperation. The revitalization of producer cooperation is crucial given the over-supply situation. For this to happen, it is essential that an overall approach be adopted whereby cross-commodity trade-offs can occur in order to take account of the growing diversity of interests among and within producer countries. In this context, efforts would have to be made at introducing forms of supply management. The purpose here should not be to perpetuate inefficient production but rather to facilitate the transition to a new division of labour among producer countries based on comparative advantage and on diversification. Strengthened producer cooperation is also a precondition for the revival of a producer-consumer dialogue. The inclusion in such a dialogue of particular issues of concern to consumers, including for example, the influence of environmental considerations on the consumption and use of particular commodities, should provide a new impetus to strengthened international cooperation on commodities.

315. In the context of the contemporary changes in the international commodity economy, the priorities of a strengthened international commodity policy in the 1990s should be to create the conditions for:

(a) Balancing supply and demand of individual commodities at improved real price levels;

(b) Optimizing the contribution of the commodity sector to development, including through diversification; and

(c) Ensuring environmentally-sound management of natural resources with a view to sustainable development.

1. Balancing supply and demand of individual commodities at improved real price levels

316. As already noted the evolution of commodity markets during the 1980s has led to short-term price instability becoming a less important problem than medium- to long-term price depression resulting from over-supply and, in some cases, from weak demand. The latter problem needs to be tackled through creating conditions aimed at strengthening the demand for primary commodities, making supply more responsive to the market situation and improving price levels over a period of time.

317. The conditions necessary for strengthening demand for commodities include the elimination of consumption taxes, especially on tropical products, and of restrictions on imports of primary and processed commodities wherever they exist. The easing of foreign-exchange shortages in Central and Eastern Europe would help considerably, as also in developing countries where per capita consumption levels for many commodities are comparatively low. In addition, increasing consumption will call for expanded promotional activities, and the development of new end-uses.

318. The conditions necessary for making supply more responsive to the market situation basically entail changes in policies which induce uncompetitive production. Such policies concern, in particular, production subsidies, especially in the developed countries, and domestic policies pursued in developing countries aimed at increasing export volumes without regard to the market situation. Other key conditions for improving price levels are the removal of supply overhangs, the elimination of export subsidies and improved information flows on market prospects.

2. Optimizing the contribution of the commodity sector to development, including through diversification

319. Optimizing the contribution of commodities to development in developing countries will call for a variety of strategies in the short- to medium-term. For developing countries dependent on one or two commodities for the bulk of their export earnings, every effort must be made to diversify productive capacities and exports, both horizontally and vertically. For those already having a more diversified commodity export base, optimizing the contribution of commodities to development would require using part of the resources generated by the commodity sector to develop their manufacturing and services sectors. For both groups of countries the essential condition is to enhance their capacity to manage commodity dependence through commodity policies, set within the context of an appropriate macroeconomic framework. This should include adequate incentives for private entrepreneurship, and support from the public sector, notably in the fields of human resources development, information and infrastructure, as well as, where necessary, direct participation.

320. Such commodity development policies will require decisions on a wide range of issues: meeting food requirements and improving food distribution domestically; improving productivity in the commodity sector; finding alternative or new end-uses for commodities through concerted actions on research and development; determining the best options for diversification and for processing; improving export marketing and distribution arrangements; and meeting the financial needs of the sector. Decisions on productivity and diversification will need to take into account the possibilities of over-supply, and hence will need to be coordinated, to the extent possible, with those of other countries.

321. Strengthening the linkages between the commodity sector and the rest of the economy will help to optimize the sector's contribution to development. Horizontal diversification for domestic consumption, increased production of goods for use in the commodity sector, and processing will serve this purpose, while expanding the productive and industrial base of the economy.

Strengthening the involvement of developing countries in support services for the commodities sector and in the marketing, transport and distribution of their commodities can also increase the contribution of commodities to development while stimulating the development of the services sector.

322. Instability in foreign-exchange earnings from commodity exports adversely affects the implementation of commodity policies. In this connection, a distinction must be made between the need for bridging finance for temporary export earnings shortfalls and the need for assistance for recurring shortfalls in commodity earnings. Bridging finance is in principle available in the form of commercial loans, and as drawings under the IMF Compensatory and Contingency Financing Facility, of which little use has been made in recent years. Finance to deal with recurring shortfalls in individual commodity exports is available through the EEC/ACP STABEX and SYSMIN, the EEC STABEX-LDC-ALA and the Compensatory Financing Programme of the Government of Switzerland. However, these are restricted in their commodity and country coverage, and their funding is limited. Other instruments that can be used to cope with individual commodity price instability include futures and options, swaps and bonds, and long-term contracts, as well as buffer-stocking and export quotas in commodity agreements.

323. It is highly unlikely that developing countries attempting to manage their commodity dependence will have at their disposal the required technical and financial resources. Technical cooperation for the formulation of commodity policies, and for their implementation will have to be provided. The call made at UNCTAD VII for an adequate expansion of financial resources for diversification projects and programmes, possibly through special facilities for this purpose, is still apposite.

3. Ensuring environmentally-sound management of natural resources with a view to sustainable development

324. Commodities are at the heart of the question of sustainable development. National and international commodity policies must take on board ecological and environmental considerations and use them in a constructive fashion, including to promote trade. The central issue is how to manage rationally the natural resources of the planet so as to maximize their contribution to the welfare of the present generation while allowing for a sustainable rate of exploitation in the future.

325. As already discussed, a key element in such environmentally-sound management is for the prices of all final products to reflect fully the costs of environmental degradation and pollution. Account has to be taken of the extent to which the environment has already been degraded in individual countries as a result of past productive activities in order to ensure an equitable sharing of responsibilities and costs.

C. Policies, measures and actions

326. The three priorities outlined above could be the basis for a commitment by the international community to the evolution of an effective international commodity policy. Domestic policies alone, however sound, cannot create the conditions necessary to fulfil the goals implicit in these priorities: all of

them require the development of concerted and consistent international policies. In certain aspects these policies will require greater reliance on market forces than in the past, notably in the area of agricultural pricing and marketing arrangements. In others, an increased role for governments will be necessary at national and international levels, notably in the areas of environmental protection and food security.

327. Achieving the appropriate mix of national and international measures and actions will require comprehensive commodity consultations in appropriate international forums. Ensuring consistency and coherence among the results of these consultations and thereby facilitating the evolution of policy is a crucial task. In order to contribute to this effort, the intergovernmental organs of UNCTAD, in particular the Committee on Commodities, will need to exercise more effectively their responsibilities in the area of commodity policy.

328. The measures which require renewed consideration by the international community involve producer-consumer cooperation, producer cooperation and support from international institutions.

1. Producer-consumer cooperation

329. Organized and focused cooperation between commodity producers and consumers must underpin the evolution of an effective international commodity policy and in this context commodity agreements and arrangements of various types could play an important role, taking into account the particular characteristics and situation of individual commodities. The active and full participation in such arrangements of both governments and industries in developed and developing countries, producers and consumers alike, is essential. Such cooperation will need to focus on the priorities described earlier, and especially the objective of balancing the supply and demand of individual commodities at improved real prices. A fresh and thorough examination is needed of the operation and functioning of international commodity agreements and arrangements. This should include the possibility of incorporating new objectives and mechanisms, for example covering environmental considerations, specific developmental measures, measures to improve market transparency, and, as appropriate, economic provisions which take market realities more fully into account.

330. International commodity bodies should give priority to improving exchanges of information and more detailed discussions on market situations and prospects as a prerequisite for actions aimed at improved real prices. The latter could involve rationalization of supply including, where appropriate, production and export controls and, for temporary imbalances, the use of buffer stocking measures. Supportive actions by producers and consumers to stimulate demand are the removal of tariff and non-tariff barriers to imports of commodities in primary and processed forms, promotional campaigns and the development of new uses for commodities. On the supply side, supportive actions that are necessary include further productivity improvements. Full advantage should be taken of the opportunities offered by the resources of the Common Fund in this regard.

331. Priority actions by producers and consumers to improve the contribution of individual commodity sectors to economic development must be aimed at establishing arrangements for improving exchanges of information on marketing mechanisms and market and industry structures. Further supportive actions will need to involve: providing training for the development of appropriate skills for enhancing productivity, for strengthening processing capabilities, for marketing and distribution as well as for the assessment of natural resource bases; facilitating the transfer and development of technologies including those for coping with environmental problems arising from production and processing; and facilitating the mobilization of finance for the commodity sector *inter alia* through joint ventures for processing and distribution.

2. Producer cooperation

332. Experience shows that producer cooperation is a *sine qua non* for effective producer-consumer cooperation. Producers should develop an overall policy on their mutual cooperation which will take into account the complementarities and reciprocity of interests among them.

333. Improving the demand/supply situation should be given the highest priority, involving the creation and strengthening of mechanisms for regular exchanges of information on production, investments and exports, with a view to achieving common aims in these areas. Coordinated actions such as supply management to avoid or remove large stock overhangs need to be considered. Arrangements of this type have proved useful in the past.

334. Supportive actions to assist countries to optimize the contribution of their commodity sectors to development, should include arrangements for sharing experience and expertise; for joint research and development to improve species, production and processing techniques, to identify and test new end-uses; and for promoting quality improvements. Moreover, producers would benefit from a more systematic exchange of information on marketing techniques and from the establishment of joint arrangements for marketing and distribution and for negotiations, for instance, with shipping conferences. In addition, producer cooperation is fundamental for the effective management, exploitation and preservation of transborder resources including fisheries.

3. Support from international institutions

335. International institutions provide forums for the evolution of an effective international commodity policy. In addition, those concerned with financial and technical assistance to the commodity sector will need to provide support for the actions by producers and consumers to balance supply and demand at improved real prices. In this regard, the potential of the Common Fund for Commodities should be fully exploited especially for the financing of commodity development programmes and projects. International organizations should continue to stimulate improvements in market access for commodities in primary and processed forms and to facilitate the realization of latent demand.

336. In providing support to developing countries to optimize the contribution of their commodity sectors to development, especially through projects and programmes for rehabilitation, expansion, diversification and processing, international institutions should also improve the collection, accessibility and dissemination of statistical and other economic data including those on industry and market structures for commodities. They should provide technical assistance to enable the full use of such data in analysis and decision-making, and provide increased training for policy makers and managers for the design and implementation of commodity policies and for establishing priorities among competing claims for resources. Above all, they will need to increase the financial resources available for such projects and programmes. This could be done through creating special facilities in particular to support diversification in the highly commodity dependent countries, improving existing facilities in the area of compensatory finance of export earnings shortfalls and through facilitating the mobilization of private investment.

337. The earmarking of financial assistance for developing countries will also be required to ensure the sound management of natural resources, including for example the task of determining the ecological impacts of their exploitation, providing compensation for their non-exploitation where there is agreement that such resources need to be preserved for the benefit of mankind, and for financing the use of expensive remedial technologies. International institutions will also need to establish and promote the application of equitable norms for environmental protection and ecological rehabilitation and ensure that environmental costs are equitably and universally taken into account, notably in the determination of final prices for products.

338. Current shortcomings in international commodity policy impede the ability of international institutions to respond effectively to the acute difficulties faced by commodity dependent developing countries. The assistance and advice being provided by these institutions need to be set within a coherent framework, so as to ensure that they do not exacerbate such problems as excess supply or protectionist reactions. They must be mutually reinforcing if they are to contribute to a strengthened international commodity economy. However, the latter will only come about if an enhanced substantive dialogue is undertaken among producers and among consumers as well as between them with the aim of evolving a considerably strengthened and qualitatively upgraded international commodity policy.

Notes

1/ The substantive agenda item of UNCTAD VIII reads as follows:

8. Strengthening national and international action and multilateral cooperation for a healthy, secure and equitable world economy.

> Evaluation of challenges and potentials presented by long-term structural changes for sustainable development and expansion of international trade in an interdependent world economy. Promoting economic growth, technological capabilities and accelerated development in the developing countries: adoption of sound national and international policies and measures, good management and structural reforms in both developed and developing countries to achieve the effective and efficient allocation, use and mobilization of human and economic resources and a more favourable international economic environment. Towards this end, issues in the following interrelated areas would be addressed: Resources for Development; International Trade; Technology; Services; Commodities.

2/ Good governance has been variously defined in these forums. In narrower terms it has been used to refer to a public service that is efficient, a judicial system that is reliable and an administration that is accountable to its public. Broadly conceived, it has been defined to cover at one level the accountability of leaders to their peoples, the establishment and proper enforcement of transparent legal frameworks, scrupulous respect for the rule of law and due process, independence of the judiciary, a pluralistic institutional structure, popular participation and vigorous protection of human rights and the press; and at another level it also includes the transparency of public transactions, the proper administration of funds, the reform of the civil service, the streamlining of administrative regulations, the overhauling of procurement procedures, and an independent public auditing system.

3/ Journal of Comparative Economics, vol. 14, No. 4, December 1990: See papers presented to the Conference on Advances in Indicative Planning held in April 1990 at the Brookings Institution, Washington D.C.

4/ For valuable examples of this search, see ECA, African Alternative Framework to Structural Adjustment Programmes for Socio-Economic Recovery and Transformation: ECLAC, Changing Production Patterns with Social Equity; South Commission, The Challenge to the South.

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ACCELERATING THE DEVELOPMENT PROCESS

Challenges for national and international policies in the 1990s

REPORT BY THE SECRETARY-GENERAL OF UNCTAD TO UNCTAD VIII

Corrigendum

Paragraph 32, penultimate line

For dependence on intraregional markets *read* dependence on extraregional markets

Paragraph 199, second line

For trade policy *read* trade liberalization

Paragraph 201, second sentence

The second sentence should be amended to read as follows:

> In particular, an undervalued real exchange rate is often a major determinant of trade performance, whereas an overvalued exchange rate is often considered a useful tool in an overall programme to counter inflation.